

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION

WASHINGTON, D. C.

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ORDER NO. 773

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IN THE MATTER OF:

Served January 26, 1968

Application of D. C. Transit  
System, Inc., for Authority  
to Increase Fares.

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Application No. 453

Docket No. 156

Application of D. C. Transit  
System, Inc., for Authority  
to Increase its Fleet in Lieu  
of Purchasing Buses.

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Application No. 436

Docket No. 156

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APPEARANCES:

HARVEY M. SPEAR, LAWRENCE W. HANTMAN, SAMUEL M. LANGERMAN,  
attorneys for D. C. Transit System, Inc., Applicant.

S. HARRISON KAHN, attorney for Alexandria, Barcroft, and  
Washington Transit Company, Protestant.

TILFORD E. DUDLEY and WILLIAM A. GRANT, attorneys for the  
Democratic Central Committee of the District of Columbia,  
Intervenor.

ALFRED S. TRASK, for the Federation of Citizens Associa-  
tions of the District of Columbia, Protestant.

DIANA K. POWELL, pro se and for Republican Precinct 17,  
Protestant.

WILLIAM O. DOUB, People's Counsel for the State of Maryland,  
Intervenor.

RUSSELL W. CUNNINGHAM, General Counsel, Washington Metropolitan  
Area Transit Commission.

BEFORE GEORGE A. AVERY, CHAIRMAN, AND SOLOMON LISS, VICE  
CHAIRMAN.

On September 1, 1967, D. C. Transit System, Inc. ("D. C. Transit"), filed Application No. 453 with the Washington Metropolitan Area Transit Commission ("Commission") seeking authority to increase certain of its fares for the transportation of passengers intrastate within the District of Columbia and Maryland, and interstate between the District of Columbia, Maryland and Virginia.

D. C. Transit's application, accompanied by appropriate tariffs, testimony and exhibits, requests authority from the Commission to establish the following fares:

1. Cash fare of 30¢ for regular route service within the District of Columbia (presently 25¢ cash).

2. Four tokens for \$1.10 for regular route service within the District of Columbia (presently 4 for 98¢).

3. Transfer charge of 5¢ for regular route service within the District of Columbia, except for students using school tickets (presently free of extra charge).

4. Discontinue sale of D. C. Transit interline ticket (presently 35¢ cash plus 5¢ additional in fare box).

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5. Discontinue acceptance of interline ticket sold by other carriers (presently accepted with deposit of 5¢ in fare box).

6. Discontinue sale of 40¢ ticket for Maryland - District of Columbia local interstate service.

7. Cash fare of 40¢, or 13¢ plus a valid D. C. Transit District of Columbia transfer or token, for Maryland - District of Columbia express interstate service between the District of Columbia and the Maryland - District of Columbia Line (presently 35¢ cash, or 10¢ cash plus a valid D. C. Transit transfer or token).

8. Cash fare of 33¢ plus either a valid D. C. Transit District of Columbia transfer or token for Capitol Hill Express Service (presently 40¢ cash plus valid D. C. Transit transfer).

9. Cash fare of 75¢ for seasonal operations between points in the Washington Metropolitan Area and D. C. Stadium (presently 60¢).

10. Discontinue issuance and acceptance of transfers on the Silver Rocket Express.

On September 15, 1967, the Commission issued Order No. 735 which scheduled the matter for public hearing, made provision for the availability of D. C. Transit's proposed testimony and exhibits, and directed applicant to post on its buses, and publish in a newspaper, notice of the time and place of the scheduled hearing.

Order No. 739, served September 29, 1967, suspended applicant's Supplement No. 2 to WMATC Tariff No. 35, Supplement No. 1 to WMATC Tariff No. 38, Supplement No. 1 to WMATC Tariff No. 4, Supplement No. 1 to WMATC XA No. 2, Supplement No. 1 to WMATC XA No. 3, and Supplement No. 1 to WMATC XA No. 4, and assessed applicant the sum of \$12,000, the sum reasonably anticipated to compensate an independent public utility consultant having expertise in, and knowledge of, the subject of rate of return.

On May 26, 1967, D. C. Transit had filed Application No. 436 with the Commission seeking authority to increase its fleet of mass transit buses in lieu of purchasing buses pursuant to Commission Order No. 362, as follows:

1. Purchase or lease 25 new air-conditioned buses.
2. Purchase or lease 45 used diesel buses (of model years 1956 or later), such buses to be reconditioned and to have air-conditioning installed if they are not air-conditioned.
3. Recondition and return to service 30 buses currently owned by D. C. Transit which have been previously removed from service, such buses to be used only during rush hour periods and for "tripper" service.
- ~~4. Sell between 20 and 25 over-the-road buses currently used exclusively for charter and sightseeing operations.~~
5. Substitute the above actions for the provision of Commission Order No. 362 which required the purchase in 1964 and each year thereafter of a number of new air-conditioned buses equal to one-twelfth of D. C. Transit's fleet of buses.

Application No. 436 was still pending final determination when Application No. 453 was filed. It was obvious that each of these applications would have a serious effect on the other. Accordingly, the Commission issued Order No. 741 on September 29, 1967, consolidating the applications for hearing in Docket No. 156 and requiring publication in a newspaper of the time and place of the scheduled hearing.

Notice having been duly given in accordance with the Commission's Rules and Regulations, public hearings began on October 12, 1967. Five formal parties were admitted to the proceeding, and the Commission processed in excess of 85 informal protests, petitions and letters in connection with the proposed fare increases, bearing more than 1,155 signatures. Two evening sessions of the public hearings were held, one in the District of Columbia and one in Maryland, to afford interested persons, other than formal parties, an opportunity to present their views. On these occasions 7 persons appeared and made statements for themselves or for organizations they represented. Such statements constituted 257 pages of transcript.

Fifteen sessions of the public hearing were held between October 12, 1967 and January 18, 1968, inclusive, producing 111 exhibits and a transcript of 2,716 pages.

D. C. Transit presented the testimony of its Vice President and Controller, Samuel O. Hatfield; its Vice President, Research and Development, William E. Bell; and John F. Curtin of Simpson and Curtin, independent consultants.

The Commission's staff presented the testimony of its Chief Engineer, Charles W. Overhouse, and of its Chief Accountant, James P. Marquart, and the testimony of David A. Kosh of Kosh-Glassman Associates, an independent rate of return consultant.

Protestant Powell presented the testimony of herself and Miss Marie F. Harley, a rider of applicant. Intervenor Democratic Central Committee of D. C. adduced testimony of applicant's witness Hatfield and of Mr. Paul D. Pearlstein. Protestant Federation of Citizens Associations presented the testimony of Mr. Alfred S. Trask. Protestant A. B. & W. Transit Company presented the testimony of its Vice President and General Manager, Richard F. Lawson.

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With the exception of A. B. & W., all of the protestants and intervenor Democratic Central Committee opposed the fare increases proposed for regular route service in the District of Columbia. A. B. & W. opposed only the proposal to discontinue the "interline ticket" arrangement.

Oral argument was presented by Harvey M. Spear, attorney for applicant; and by William A. Grant, attorney for intervenor Democratic Central Committee of D. C.; and by S. Harrison Kahn, attorney for A. B. & W. Transit Company, Alfred S. Trask representing the Federation of Citizens Associations of D. C., and by Miss Diana K. Powell, Protestant.

By this opinion and order, we are, for the second time in less than a year, raising D. C. Transit's fares. In the material which follows we discuss in detail, in accordance with accepted methods of analysis in rate proceedings, the evidence presented to us in this proceeding and the conclusions we draw therefrom. It would perhaps be well to state at the outset in somewhat simpler terms the essential nature of the problem. We set rates which will produce revenue sufficient to cover all the company's expenses and provide it with a fair return. This is done by projecting revenues and expenses for a period of time in the future. The simple fact is that over the 12 months ending October 31, 1968, D. C. Transit will be required under its labor contract with its operators' union to pay wage increases which will increase its total labor expenses by about \$1,500,000. The money to cover these expenses must be generated somewhere and, under present circumstances, the only source for that is the fare box.

The company's expenses have been rigorously examined, and only those which are both justifiable and reasonably predictable have been allowed. We have carefully considered the amount of return, or profit, which should be allowed to the company and we have, after careful deliberation, arrived at a rate of return which is fair and equitable to the applicant as well as to the ratepayers.

A central fact about the present rate case is that it follows so closely upon the last such case. By our Order No. 684, we granted the company certain fare increases effective March 15, 1967. The decision to file the present case was made by company management in early June, 1967, at a time when it had available only two months of results under the increased fares. Indeed, the company's case, as first presented to this Commission, was based on data for a historical year ending May 31, 1967 -- a year, therefore, which included only two and one half months of experience under the new, higher fare structure. The Commission was not content with just that data, however, and the record now contains information as to the company's operating results through November, 1967, i.e., for eight full months following the fare increase. In the eight full months from April through November, 1967, the company had operating revenues of \$24,615,223; operating revenue deductions of \$23,228,859; and a net operating income of \$1,386,364. This produced a rate of return on gross operating revenues for the eight month period of 5.63%. <sup>1/</sup>

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It appears, therefore, that the rate increase we granted in March, 1967, achieved the results we sought and that since it was instituted, the company has operated in a financially healthy condition. We regard these figures as important since they are the best indication of the company's current financial condition. They are certainly more useful than figures for past periods which include operations under the old fare structure. We have used these current figures to test the validity of a number of projections made by the

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<sup>1/</sup> The outlook for the twelve month period following the rate increase may be even better than these figures indicate since the eight month period contains fluctuations which may smooth out over the full twelve month period. For instance, on a month by month basis, the rate of return has fluctuated from a high of 10.24% in June, 1967, to a loss of 2.20% in November, 1967. In the latter month, operating revenues were 7.7%, or \$204,000 over the same month of the previous year; operating expenses increased at the lower rate of about 5.8%, or \$141,000. November, 1966 showed a net operating income mainly because of a \$190,000 credit adjustment for income taxes, whereas November, 1967 had no provision for income taxes whatever. Judging from the income statement produced by the company for the 11 months ending November 30, 1967, an income tax credit adjustment, similar to the one made in November, 1966, should also have been made in November, 1967, converting the book loss to a book profit for the month.

It is important to bear in mind that the operating results quoted here are company figures which have not been subject to audit review beyond August, 1967.

parties. Obviously, this exposition of current operating results does not end our inquiry since we set rates not on the basis of past results but in futuro, on the basis of projections for a future annual period. The future annual period used by both the company and the staff in this proceeding was the twelve-month period ending October 31, 1968. We conclude that in that period the company can expect the following results, assuming no change in fares.

TABLE I

Operating Revenues:

Passenger Revenue	\$ 34,320,612
Charter	2,229,650
Government	127,790
Limousine	--
Station and Vehicle	169,153
Other	76,255
Total	\$ <u>36,923,460</u>

Operating Revenue Deductions:

Operating Expenses	\$ 31,997,863
Taxes, Other than Income Taxes	1,074,753
Income Taxes	106,467
Depreciation	2,394,647
Amortization of the Acquisition Adjustment	(194,516)
Total	\$ <u>35,379,214</u>

Net Operating Income	\$ <u>1,544,246</u>
Rate of Return	4.18%
Operating Ratio	95.82%

The extent to which differences existed in the forecasts of the parties can be seen <sup>2/</sup>by operating results estimated by the applicant in its Exhibit No. 45:

Gross Operating Revenues	\$ 36,521,343
Operating Revenue Deductions	<u>35,949,452</u>
Net Operating Income	\$ 571,891
Percentage of Net Operating Income to Gross Operating Revenues	1.57%

<sup>2/</sup> Exhibit 45 was part of the company's rebuttal testimony. It had previously forecast gross operating revenues for the future annual period at \$36,411,558, operating revenue deductions of \$35,628,437, and net operating income of \$783,121 -- a return of 2.15% on gross operating revenues.

In reaching this conclusion we have resolved certain issues of fact which should be discussed at this point. First, there were certain items of revenue in dispute between the staff and the company.

### Passenger Revenues

We accept the staff's figure for passenger revenues. This figure was reached by taking as a base the passenger revenue figure for the twelve months ending October 31, 1967. This figure was then adjusted in two ways. First, a resistance factor of .20% for each 1% increase in fares was applied to the figures for the period November 1, 1966 through March 31, 1967 to give retro-active effect to the fare increase granted in March, 1967. Second, the figures for various passenger groups such as token, cash, etc. were adjusted by applying growth or decline trend factors developed for each such group.

The staff figure for passenger revenues is higher than the company's figure by some \$299,000, principally because the staff used a resistance factor of .20% for each 1% increase in fares while the company used a .328% resistance factor. We believe the staff's approach was more accurate. The company purported to develop its .328% figure from data related to the last fare increase but its approach was questionable. In March, 1967, the cost of tokens was increased from 4 for \$.85 to 4 for \$.98 but the cash fare remained at \$.25. The result was that many riders switched from using tokens to paying cash. The company developed a figure for the number of persons who stopped riding altogether, as well as a figure for the number who switched from tokens to cash. However, when they computed the percentage of token riders lost, they excluded from consideration the number of passengers who switched from tokens to cash. In other words, the company applied the computed number of lost riders to the total number of token riders excluding those who switched and determined a percentage of loss. This methodology ignores the fact that those who switched were not lost customers and exaggerates the degree of loss.<sup>3/</sup>

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<sup>3/</sup> A hypothetical example may illustrate the fallacy more clearly: Without the fare increase the company, in a given period, would have had 25,000,000 token riders. The actual number of token riders, with the fare increase, was 14,000,000. Analysis reveals that 10,000,000 token riders switched to cash and 1,000,000 stopped riding. The company lost not one out of 14 riders, as it would claim, but one out of 25.

Independent checks of the results achieved confirms the fact that a resistance factor of .20% is more valid than the company's .328%. The factor of .20% has been used repeatedly by both the company and the staff in the past rate cases. It was used by both in the last D. C. Transit rate case. The revenues the company is receiving are at about, or perhaps a little above, the level predicted after using the .20% figure in the last rate case. If the .328% factor were valid, the company would not currently be receiving revenues of this magnitude.

The company itself indicated some doubts as to its methodology. Using its method of calculating the percentage of token riders lost which excluded from consideration those who switched to cash, the company initially concluded that it had lost over 6.2% of its token riders. The company itself then arbitrarily reduced this percentage loss by 20%, i.e., down to 5.01% (Co. Ex. 3, Sch. 1A Corrected). This indicates that the company itself had some doubts about the result it reached.

In any event, in our judgment it is sounder to use the .20% resistance factor used by the staff in this case and by both the staff and the company in past rate cases. Hence, in Table I above, passenger revenue for the future annual period at present fares is \$298,763 higher than was urged by the company because we have used a lower retroactive resistance factor than that used by the company.

Note that we are adopting the .20% factor only in dealing with the historical period, which has the effect of carrying forward into the future annual period as long as there is no change in fare structure. To the extent that any changes are made in the fare structure, to that extent judgment must be exercised in determining whether or not the .20% resistance factor experienced in the past will continue or whether possibly a greater resistance will make itself felt due to the nature of changes which may be made. This will be discussed at a later point in this order.

#### Charter Revenues

In Table I above, we project charter revenues for the future annual period in the amount of \$2,229,650. Originally, the company had projected \$2,028,733, a figure based solely on the judgment of its management that charter revenues in the future annual period would be substantially the same as in the period ending May 31, 1967. The staff projected charter revenues at a higher level than the company based on an analysis of growth trends for charter work and the company eventually accepted the staff's estimate with the exception of one item. The company's estimate for charter revenues was raised by \$120,963 (Exh. 45), leaving \$79,954 in dispute. This represents estimated sightseeing revenue generated in nearby Virginia.

The company claims that we should eliminate the entire amount presently attributable to sightseeing patrons who are picked up at their Virginia



hotels and transported to D. C. Transit's sightseeing headquarters in the District at no additional cost to the patron. This pickup service was performed for D. C. Transit by its subsidiary W. V. & M. under charter arrangement. The staff claims that this arrangement is unauthorized and would disallow the expense of the charter. D. C. Transit counters that if this is done the entire revenue must be eliminated. In our view, a substantial number, if not all, of these patrons would still use D. C. Transit's sightseeing service even if free transportation to the District were not provided. We believe D. C. Transit's elimination of this item is too speculative and we accept the staff's estimate in toto.

#### Station and Vehicle Revenue

There is only one item in dispute in this category. The staff recommends that we impute income to D. C. Transit in the amount of \$23,400 attributable to the fact that D. C. Transit makes available on its buses space for the distribution of the D. C. Examiner. This is a newspaper published once a week which is owned by the principals of D. C. Transit. The paper is placed on D. C. Transit buses and is free to bus patrons. The staff points out that this distribution to bus riders is of value to the Examiner's publishers. They can point out to potential advertisers a "captive" audience of many thousands of persons. D. C. Transit counters that it also derives benefits from the arrangement in that it is able to provide an amenity to its riders, i.e., a free copy of a newspaper which sells on news stands for \$.10. It seems clear, however, that the benefits, in monetary terms, to the Examiner clearly outweigh the benefits to D. C. Transit. It can be said that D. C. Transit receives monetary benefits from the Examiner only if it is believed that some persons ride the bus in order to obtain a free copy of the paper. D. C. Transit offered no proof that there were such persons and we feel that it is contrary to common sense to believe that there are. On the other hand, the availability of readership among bus patrons must be of considerable value to the Examiner in selling advertising and, beyond question, increases the revenues from that source. Hence, we believe that the bus company should be compensated for the benefit it makes available to the advertiser. The amount suggested by the staff is a conservative figure, based on estimated circulation and established distribution commission rates. We will accept the staff's figure and increase the company's estimate of station and vehicle revenues by that amount.

#### Operating Revenue Deductions

Turning now to expenses, the figures shown in Table I above are the result of certain determinations we have made concerning disputed items of expense and we will discuss each of these items separately.

#### Wage Expense

The company projects wage expenses for the future annual period at a level \$430,259 higher than the staff's projection. As in past rate cases, the difference involves the treatment of wage increases based upon the cost

of living index. In this case, however, the problem is somewhat different than that we have previously faced. In past rate cases, the labor contract provided that at certain dates, after the conclusion of the rate case, wage increases would be granted, provided that on the date involved, the price index had increased to a certain level. The company urged us to find that the index would indeed increase to the pertinent level and asked us to allow for the increased wages which would result. It was our consistent policy to refuse such requests. We would not allow for wage increases that had not materialized. We included in our calculations only those wage levels justified by the price index at the time we were rendering our decision.

The contract now before us differs from the earlier contracts just described. It guarantees "cost of living" increases in certain fixed amounts at stated intervals up to April 28, 1968. These increases will total  $7\frac{1}{2}$  cents per hour by April 28, 1968. At that date, a further fixed increase of  $7\frac{1}{2}$  cents per hour becomes payable. However, at the same time, the previously mentioned "cost of living" increases must be reassessed. If the Consumer Price Index at February 15, 1968, has fallen back to the level at which it stood on August 15, 1966, all of the previously granted "cost of living" increases totalling  $7\frac{1}{2}$  cents per hour will be eliminated. Similarly, some portion of the "cost of living" increases could be lost if the index at February 15, 1968, is above the August 15, 1966, level but is not sufficiently high to justify, under a stated formula, the full  $7\frac{1}{2}$  cents per hour "cost of living" increases granted up to April 28, 1968.

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The staff characterizes the "cost of living" increases as being "unguaranteed" after April 28, 1968. As previously noted, we have regularly disallowed wage increase expense attributable to cost of living increases which will occur in the future only if the index increases to a certain level. The staff disallowed the expense of the previously described "cost of living" increases after April 28, 1968.

We do not agree with the staff's treatment of this expense. Specifically, we do not agree that disallowing the "unguaranteed" cost of living increases here in question for the period subsequent to April 28, 1968, would be consistent with our past practice of disallowing future cost of living increases. What we have done in the past is to allow those increases called for by the index level at the time we were preparing our decision but we have refused to predict what future index levels might be.

Disallowing the cost of living increases in the manner suggested by the staff would, of necessity, involve a prediction as to the level of the index. The expense of the wage levels in question will be avoided if, and only if, the cost of living index at February 15, 1968 stands at, or is lower than, the August 1966 level. The record shows that the August 1966 level

was 114 and that the index today stands at 117.8.<sup>4/</sup> Hence, disallowing the expense in question inherently involves a prediction that the index will decline by almost four points in the next few months. We decline to make this, or any other prediction, concerning the future level of the cost of living index. What we will do is allow the wage expense which is justified by the index as it stands today. At this level, a cost of living adjustment of 11.5 cents per hour would be applicable beginning April 28, 1968, and we will allow the costs involved at that level of wage rates.

We emphasize that in allowing this expense, we are not making a prediction that in April, 1968, the index will stand where it does today. Rather, we are attempting to follow, as closely as we can in view of the terms of the current labor contract, our past practice of allowing only those wage expenses which are justified by the current cost of living index.

We conclude, therefore, that the company will incur wage expense in the future annual period which is \$1,571,657 in excess of such expenses during the historical period. The effect of this adjustment is to disallow the forecast of \$85,741 of additional wage payments which the company contends will be incurred at varying points between May, 1968 and October 31, 1968.

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#### Salary Increases

The company has projected \$174,069 for increases in salaries. The basis for this figure is the assumption that all salaried employees will be given increases of 5.43%, the percentage by which operators' wages will increase during the year. The staff has recommended that this entire item be disallowed. They base this recommendation on a study of overall salary expense during the past few years. They point out that, despite the fact that increases have been regularly granted, overall salary expense has been declining. The annual decline is approximately the amount which the company presently seeks in order to cover increases. In light of the facts brought out by the staff, we must disallow this projected expense. The company has not met its burden of proof that an overall increase in salary expense will actually occur.

#### Pension Increases

We have allowed \$146,396 for increases in pension fund contributions. Pension fund contributions amount to 9% of the wage increase allowed and 7.875% of salary increase allowed. We have applied these percentages to the amounts we have allowed for wage increases including differential pay

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<sup>4/</sup> The Consumer Price Index at the conclusion of the taking of evidence on December 20, 1967, stood at 117.3. However, the U. S. Department of Labor released the November 1967 Consumer Price Index on December 22, 1967, showing the new level at 117.8. This information was introduced into the record by the company in the course of oral argument on January 8, 1968.

increases. Since our overall figures for wage increases and salary increases differ from the totals for these categories recommended either by the company or the staff, our pension increase allowance does not agree with either the staff or the company projection for this item.

#### Savings Due to Bladensburg Consolidation

We have adopted the final figure offered by the company for this item, namely \$22,143.

#### Health and Welfare Contributions

The company ultimately projected an increase in the cost of contributions to the employees' health and welfare fund totalling \$239,112. This includes \$59,068 attributable to an increase fixed by the terms of the union contract. The remaining \$180,044 is based upon a special assessment directed by the fund's trustees on November 14, 1967. Beginning on January 1, 1968, the company will be required to pay an additional \$2.00 per week, per employee. On July 1, 1968, this will decrease to \$6.00 per month, per employee, subject to review at that time by the trustees. It was testified that the purpose of this special assessment was, first, to cover the increased cost of medical expenses, and second, to make up for past deficits in the fund. On this latter point, it was testified that the fund currently had \$200,000 in bills it was unable to pay.

The staff challenged the allowance of the special assessment. They questioned whether the assessment might be withdrawn before it was paid in its entirety. They further raised the question whether it was proper to charge the 1968 ratepayer with the full amount necessary to make up for deficits accumulated over the past.

We have considered these objections. We will assume that this assessment was made in good faith and will continue in effect throughout the period projected. We will, however, carefully watch to see to it that this assumption is fulfilled and if it is not we will take appropriate action. On the other hand, we will not allow the full amount as an annualized expense. It is unfair, in our view, to concentrate in a period of ten months the expense of making up a deficit which may well have been building up for years. While the company may actually make up the deficit at any rate it chooses, we will, for rate-making purposes require that the effect of the special assessment be amortized over a twenty-two month period ending October 31, 1969, the date on which the current health and welfare agreement expires. The effect of this determination is to allow \$80,733, attributable to this special assessment, during the future annual period. Adding this to the increase called for by the contract means that a total of \$139,801 will be allowed for this item during the future annual period.

### Legal Fees

The staff suggested that we disallow a projected amount totalling \$68,613 attributable to legal fees. The staff suggested that these were non-recurring items because they related to completed legal work. They further suggested that the legal expenses of the company were inordinately high and constituted an undue burden on the ratepayer.

The company is entitled to revenues sufficient to cover legitimate expenses. It is perhaps unfortunate, but nonetheless true, that the company has regularly incurred, and will apparently continue to incur, legal expenses in the amounts projected by the company in its exhibits. Considering the volume of litigation in which the company is involved, the amounts charged do not appear to be excessive. In these circumstances, we must allow this expense. Hence, we have rejected the staff's position on this item.

### Cost of Existing Management Structure

The staff suggested that we disallow \$57,728 in executive salaries on the ground that the existing management structure of the company is "top heavy." We have carefully considered the staff's views on this point. ~~However, we are mindful of the established principle of regulatory law that~~ it is not our function to manage those subject to our jurisdiction, but to regulate them. We do not feel that the existing executive structure of D. C. Transit constitutes a clear abuse of managerial discretion. In these circumstances, we cannot substitute our judgment for that of the company's directors as to the proper managerial structure for the company. Hence, we will reject this suggested disallowance. It goes without saying, however, that we will maintain a very close scrutiny of the company's managerial structure and we will not hesitate to disallow any expense which, in our opinion, constitutes an abuse of managerial discretion. For instance, officers whose major function vis-a-vis D. C. Transit (D. C.) is peripheral, occasional, casual, and/or advisory, must be properly identified and their salaries properly allocated.

### Cash Discounts

The staff suggests that expenses should be adjusted downward by \$25,000 to reflect the fact that in the historical period the company did not take advantage of cash discounts in the amount which would have been available for prompt payment. We will not discuss in detail at this point the cash working capital problems encountered by the company in the past. They are discussed at length at pp. 19-21 of this opinion. Suffice it to say that since our Order No. 684 became effective, the company has been earning an adequate rate of return and we anticipate that they will continue to earn such a return following issuance of this Order. In these circumstances, the company is obligated to manage its cash working capital in such a manner

that its expenses are kept at the lowest possible level. Since expenses in the historical period were inflated by the failure to take advantage of cash discounts and since continued failure to do so would be unjustifiable, we will reduce the expense allowance accordingly. Hence, we accept the staff's disallowance of \$25,000 attributable to this item.

#### Expenses of Charter Operations

As noted when discussing revenues earlier, pp. 14-15, supra, the staff projected higher charter revenues than did the company and we have accepted the staff's estimate. The staff further pointed out, however, that these additional revenues would entail further expenses and they suggested that we add \$47,655 for this item. This amount was calculated on the basis of an estimate by the Commission's Engineering Department as to the number of vehicle hours which would be necessary to produce the additional revenues. The company argues that the number of pay hours attributable to the vehicle hours should be used to calculate the additional expense. This approach was rejected by the staff witness, however. He took the position that this expense projection was a rough estimate at best and he stated that it was his judgment that the dollar expense would be in the amount he calculated rather than the higher amount suggested by the company. We accept the judgment of the staff witness on this item. The company's suggested refinement is merely adding more uncertainty to what is already an estimate. We will rely on the judgment of the staff on this item. Accordingly, we will add \$47,655 to expenses, attributable to increased hours of charter operation.

#### Suspension of Bad Debt Accruals

The staff performed a study of the reserve for bad debts and concluded that the amount in that reserve was considerably in excess of the amount needed on the basis of the company's actual bad debt experience. The amount now in the reserve would cover several years' accumulation of bad debts. Hence, the staff recommended that accruals to the reserve be suspended for the time being. The company opposes this suggestion, arguing that the accruals were based upon a study done by an independent accounting firm and that they are needed. We are more impressed with the staff's analysis of this reserve and we will accept their recommendation that the accrual expense, amounting to \$10,700 in the future annual period be eliminated.

#### Excise Tax On New Tires

When the company buys new tires, it must pay an excise tax thereon. Until now, it has been the company's practice to charge the entire amount of this tax to expenses at the time of purchase. The staff has suggested that this expense should be amortized over the life of the tire. Specifically, the staff suggests a fifteen month amortization period. They point

out that tire life varies considerably but may be as long as two years. To be conservative and fair to the company, they halve this period to twelve months. To this, they add three months in recognition of the fact of both a bookkeeping lag in recording expense and a period of time in which tires are held in inventory prior to use. On the basis of this accrual method, they would reduce expenses in the future period by \$27,883.

The company objects claiming, first, that there is no rational basis for the fifteen month accrual period; and second, that if the accrual method is adopted, an adjustment should also be made in the historical year expenses. To this latter point, the staff replies that, when a change to an accrual method is made, there must be some starting point. They believe that the best method for making the change is to start with the future annual period and go forward.

Having considered the positions of the staff and the company, we conclude that, as long as the method in use is applied consistently from period to period, no violence is done to proper accounting principles; amortizing the tax over a future period merely creates a temporary decrease in an operating cost by the use of a bookkeeping device, but the long-run result is unchanged under either method. The staff's proposal is not acceptable.

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#### Pension Contributions for Claims Personnel

The company has an annual expense of \$1,300,000 charged to its reserve for injuries and damages. Salaries and other expenses of claims personnel have been charged against that reserve. However, the expense of pension contributions and payroll taxes of claims personnel have, in the past, been charged to operating expenses. The staff has recommended that these expenses also be charged to the reserve for injuries and damages. The company counters that if this is done, the annual charge of \$1,300,000 should be increased to cover these additional expenses. It is clear that these personnel-related expenses should be charged against the reserve, just as salaries themselves are. The only question, therefore, is whether, in doing so, we should increase the annual charge.

The data concerning the reserve presented by both the staff and the company convince us that no serious harm will be done to the sufficiency of the reserve by charging these additional expenses against it without increasing the annual charge. The reserve is clearly sufficient to take this additional expense of a relatively small amount for a sufficient period of time to build an experience record of this treatment. At some future time, we can reassess the sufficiency of the annual charge, taking into account the then current claims experience as well as the effect of these new charges against the reserve. Hence, we will eliminate from operating expenses the amount of \$15,313, attributable to pension contributions for

claims personnel. We will also reduce payroll taxes by a total of \$6,148, the amount of such payroll taxes attributable to claims personnel.

#### Board of Trade Dues

The staff suggested that we reduce the amount allowed for Board of Trade dues. The expense grouping discussed involved \$620, which is made up of annual dues to the Washington Board of Trade for 11 employees at \$50.00 each, of \$550; the remaining \$70.00 was for expenditures of a social or entertainment nature. As the amount of \$50.00 for the dues of one employee had already been allowed by the staff, we will increase the expense allowance for this item by an additional \$500; the \$70.00 amount is not, in our opinion, a proper above-the-line expense.

#### Taxes

In the historical year, the company accrued \$126,000 for Maryland Motor Fuel taxes but paid taxes only in the amount of \$54,372. The amount actually paid was based upon interstate miles operated in Maryland. Apparently, there is some question whether, under the old Maryland Motor Fuel Tax Compact, taxes are also owed on intrastate miles operating in Maryland. The company does not believe they are and has paid tax only on interstate miles, while accruing expense on the higher amount. We believe it is sounder to base the allowance for taxes on amounts actually paid. Ordinarily, therefore, we would disallow the full over-accrual, as suggested by the staff. However, there is a complicating factor. The Maryland law has been changed and, effective July 1, 1968, it is clear beyond question that tax will be owed on both intrastate and interstate miles operated.

In recognition of this fact, we will allow tax expense in the future annual period on the following basis: For eight months of the period, the tax allowance shall be based on taxes actually paid, in the manner suggested by the staff; for four months of the period, we shall allow the full amount as accrued by the company. This recognizes the fact that from July 1, 1968 through October 31, 1968, the end of the future annual period, the company will be liable for the full amount. In sum, therefore, we will disallow \$38,998 of the amount projected by the company for Maryland Motor Fuel tax.

One additional tax item requires comment. On the day the company witness was preparing his rebuttal exhibits, the act increasing social security taxes was signed into law. The company hurriedly prepared an additional schedule claiming that this law would increase its social security (FICA) tax expense by \$100,000. On cross-examination, it appeared that this figure was based on an assumption that 2500 of the company's employees would earn up to \$7800 per year. No study whatever was made to support that assumption. We did not feel that the company had met its burden of proof in support of this claimed expense, and we would disallow it. However, the company and the Commission's staff have studied this problem independently and have arrived at the conclusion that there will be an additional tax cost to the company during the future annual period, on account of this



change in the law, amounting to \$70,000. This amount is recognized as an operating expense for the future annual period in this case.

#### Provision for Income Taxes

In forecasting the operating results for the future annual period, the Commission allowed provision for \$106,467 of income taxes. In arriving at this tax provision, the Commission follows the policy adopted in previous rate cases, giving no effect to investment tax credits which will accrue to the applicant in the future period. The investment tax credit on the 25 new buses purchased by the company in November 1967 will provide a credit against federal income taxes for the year 1967 in the amount of approximately \$60,000; the investment tax credit which will flow from the anticipated purchase of 85 new buses in 1968 is estimated to provide a credit against 1968 taxes in the amount of some \$200,000.

The above policy is based upon Section 203(e) of the 1964 Revenue Act, part of which is quoted herewith:

"It was the intent of Congress in providing an investment credit under Section 38 of the Internal Revenue Code of 1954, and it is the intent of the Congress in repealing the reduction in basis required by Section 48(g) of such Code, to provide an incentive for modernization and growth of private industry (including that portion thereof which is regulated). Accordingly, Congress does not intend that any agency or instrumentality of the United States having jurisdiction with respect to taxpayer shall, without the consent of the taxpayer, use --

(1) in the case of public utility property. . .

(2) . . . any credit against tax allowed by Section 38 of such Code, to reduce such taxpayer's Federal income taxes for the purpose of establishing the cost of service of the taxpayer or to accomplish a similar result by any other method."

Several state regulatory agencies have expressed the view that this Act is binding only upon federal regulatory agencies. We agree. Moreover, this Commission is not a federal agency, but is expressly an arm of the legislatures of the signatory states. Nevertheless, this agency has previously decided -- and we concur -- that the intent of Congress to provide an incentive to private enterprise to modernize should be accommodated, particularly in the field of mass transit. We have actively and affirmatively sought this goal for carriers we regulate, and, to this end, have recommended certain proposals to the Congress. It would fly in the face of reason, then, to decline to honor its action to spur carriers to modernize their equipment. Thus, Congress has acted, and the carriers under our jurisdiction have responded by massive infusion of new equipment into their fleets. Accordingly, our policy is and will be accommodation of the aim of modernization.

#### Cost of Fuel and Oil

The company projected an increase in its motor fuel costs for the future annual period in the amount of \$92,130. The record in this case shows that, when the company's fuel contract expired on April 1, 1967, it did not accept the lowest bid offered to it by a major supplier of motor fuel. Testimony shows that the company has been paying 10.4¢ per gallon for the major portion of the fuel

that it uses -- a blend of Diesel No. 1 and 2, instead of 9.95¢ per gallon which was the low bid. The difference in price between the low bid and the price now being paid is projected to amount to \$39,353 over the future annual period.

The Commission staff witness suggested that the increased fuel cost projected by the company be scaled down to reflect the lower bid price.

A great deal of testimony appears in the record about this situation; the company's Comptroller testified that he had no detailed knowledge of the negotiations underlying this major facet of his business -- but he did say that the previous supplier was owed in excess of \$350,000 at the expiration date of the old contract and there was some financial embarrassment involved in accepting a new supplier. Additional cross-examination developed the possibility that whoever was responsible for the fuel contract had made a tactical error in not accepting the low bid before its expiration date. The record shows that the company actually is buying fuel without a price-guaranteed contract today, subjecting the company to the vagaries of fuel price aberrations which may cost the company more than even forecast in this case.

The Commission will accept the company's cost projection for this item in this case, not wishing to penalize it for a mistake in business judgment.

#### Relocation of Executive and Legal Offices

The original forecast of operating expenses by the company included \$32,272 for additional rent at an office building on New York Avenue, N. W., owned by a subsidiary of D. C. Transit of Delaware; provision was also made for a reduction in operating costs at 3600 M Street, N. W., in the amount of \$24,762. Although the company's Comptroller, on cross-examination, testified that no rent was being paid for the offices of the company at 3600 M Street, the \$24,762 does represent operating expenses in lieu of rent.

The Commission's Chief Accountant disallowed the difference between these two figures, \$7,510, because he could not find any justification for the move to more expensive quarters, nor did cross-examination of the company witness develop any such justification.

Disallowance of this item of \$7,510 was acceded to when the company submitted its rebuttal testimony and excluded its original adjustment for the new rental basis on New York Avenue. This adjustment therefore will be recognized and the additional rent disallowed.

#### Depreciation

We come now to what is perhaps one of the most crucial items in this rate case -- the question of depreciation. Some background facts are needed as a setting for our decision.

On May 27, 1964, the Commission entered its Order No. 362. That Order authorized the company to depreciate its buses on a twelve year life. That

amortization period, however, was specifically made contingent upon a requirement that the company purchase one hundred <sup>5/</sup> new air-conditioned buses each year. The purchase was to be made not later than June 1 of each year. The company substantially complied with this Order each year. In the rate case held last year, which was decided by Order Nos. 656 and 684, the company's case, as well as the staff's, was predicated upon the assumption that one hundred new buses would be purchased by June 1, 1967. In that case, the company was specifically asked whether the one hundred buses would be purchased, and an affirmative answer was given.

Nonetheless, on May 26, 1967, the company filed its Application No. 436 with the Commission. In this pleading, the company asked to be excused from purchasing one hundred new buses by June 1, 1967. Instead, the company asked to be permitted to purchase twenty-five new buses, and forty-five used buses. In addition, thirty buses already in the fleet, but ready to be retired, would be reconditioned and retained in service. Affidavits filed with this application frankly stated that the company was unable to purchase the one hundred buses as required by Order No. 362 because it did not have sufficient cash working capital to make the down payment, estimated at 20% of the purchase price, or over \$600,000. This critical cash position, it was stated, was caused by the fact that for the first three months of 1967, the company had been forced to operate at a loss, after the court set aside the Commission's interim order (No. 656), which would have provided the company with revenues sufficient only to cover its expenses and interest commitments for the period needed by the Commission to determine the proper rate of return.

We directed the staff to make a direct investigation of the company's financial position and it was reported to us that it was, in fact, true that the company had incurred substantial losses in the first quarter of 1967, that the company's cash position was critical and that they did not have the cash needed to make a down payment on one hundred new buses.

While this cash position was in some measure due to the losses suffered by the company in the first quarter of 1967, a significant reason for the cash crisis is the write-off of \$1,300,000 from the court-ordered Riders' Fund during 1966 which stood in lieu of increased fares; management made no move in 1966 to supply cash for this massive transfer. However, there are additional aspects of the company's cash management upon which we feel constrained to comment. It was brought out at the hearing that, during the

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<sup>5/</sup> The requirement is actually phrased in terms of one twelfth of the fleet. Since the fleet is approximately 1200 buses, this means one hundred buses per year.

period when the company's cash position was critical, there were two significant transactions with other companies in the D. C. Transit corporate structure. First, the company was owed some \$70,000 by Transit Card Advertising Co. That company handles the sale of advertising in the interior of D. C. Transit's buses. It collects the revenues from advertisers and forwards a percentage thereof to D. C. Transit. The amount mentioned above was due D. C. Transit for advertising carried since February, 1967, but had not been paid over by Transit Card Advertising Co. That company is an integral part of the corporate structure in which D. C. Transit exists and ultimate control of the funds of Transit Card is in the same hands as those which control D. C. Transit. It was stated by the company's witness that the bill had not been paid because Transit Card was also suffering from a cash shortage. Nonetheless, shortly after it was brought out at the hearing that this sum was due and owing, it was paid in full to D. C. Transit by Transit Card.

The second transaction involves M Street Estates, Inc., a wholly owned subsidiary of D. C. Transit System, Inc., of D. C. On May 1, 1967, D. C. Transit made a payment to M Street Estates of \$225,000 on a note of D. C. Transit held by M Street Estates. Five days later, M Street Estates advanced \$100,000 to D. C. Transit. The net result of these transactions was an outflow of cash from D. C. Transit to M Street Estates of \$125,000, at a time when D. C. Transit's cash position was critical. No explanation was given in the record as to why this transaction took place. It is clear, though, that once again, despite the fact that transfers between separate corporations are involved, the ultimate control of these funds rested in the hands of those who control D. C. Transit. That control was exercised to remove cash sums from D. C. Transit and send them to another company in the corporate structure.

Neither of these latter two transactions, alone or together, would have made a sufficient change in the company's cash position to have solved the hundred bus purchase problem. We mention them, however, because they do not live up to the company's responsibilities as an enterprise affected with a public interest. In the management of its cash working capital, the company's guiding principle must be the maximum protection of its ability to meet its obligations under its franchise, the Compact, and Commission orders. In the two instances discussed, the company in our view, departed from this guiding principle and we would be remiss if we did not point out its failure and direct its attention to its responsibilities.

Recent events indicate that the company is now more aware of its obligations and taking action to meet them. At the final session of the hearing, it was announced by the company's counsel that the company had obtained a loan of \$1,000,000 secured by a mortgage on 3600 M Street, N. W., one of its non-operating properties. It has since been determined that the loan was made to a subsidiary of D. C. Transit in

the amount of \$1,500,000; of this amount, \$1,000,000 was deposited to the credit of D. C. Transit on December 28, 1967; of this amount, \$688,000 remained in the main working cash account of the company, and \$312,000 was distributed among inactive bank accounts of the company.

Ever since we first became aware of D. C. Transit's critical cash position, we have engaged in discussions with the company about the problem and have urged them to raise the cash needed for transit operations through their non-operating properties, if no other sources are available. We are pleased that they have recognized their obligations in this regard and have acted for the benefit of the transit rider.

Returning now directly to the problem of depreciation, at the time D. C. Transit filed its Application No. 436, seeking relief from its obligation to purchase 100 new buses, we were, as stated earlier, faced with the fact that D. C. Transit did not, in fact, have sufficient cash working capital to effect the purchase. We regarded the proposal to buy 45 used buses as undesirable and we undertook efforts, as referred to in preceding paragraphs, to have the company remedy its cash position, meanwhile deferring action on Application No. 436. In addition, we directed the company to purchase the twenty-five new buses which it stated it was in a position to purchase despite its cash problems. Those buses were in fact purchased and are now in service in the fleet.

On September 1, 1967, the company filed its rate increase application, in which it asked that its depreciation be based on a fourteen year life, rather than twelve years, and that its bus purchase requirement be reduced to eighty buses per year. Because the issues raised by this request were so intimately bound up with the issues raised by Application No. 436, we consolidated the two applications for purposes of hearing and decision.

At the hearing, D. C. Transit presented evidence supporting a change to a fourteen year life, urging that it would not affect standards of service to a significantly adverse degree. The Commission's Chief Engineer urged that we continue both the twelve year depreciation rate and

the one hundred bus purchase requirement. However, the Commission's Chief Accountant prepared his financial exhibits on the basis of a fourteen year life (beginning June 1, 1967) so that they would be more directly comparable to the company's figures. However, he pointed out the inadvisability of a retroactive depreciation adjustment. He provided us with a calculation that using a twelve year life would increase depreciation expense and thus the amount which must be produced from the fare box, by approximately \$500,000.

We must come to grips now with a fundamental question raised by the existing requirement that the company purchase one hundred new buses annually and depreciate its fleet on a twelve year life. This requirement undoubtedly maintains the quality of the fleet at a very high level but it also imposes a financial burden upon the company, a burden which must ultimately be borne by the ratepayer. Specifically, in the future annual period, to remain with the existing program rather than go to a fourteen year life and a program of annual replacement of 1/14th of the fleet, the ratepayer will have to provide the company with about half a million dollars in additional revenue.

Maintaining a high standard of quality in the fleet of D. C. Transit is of great interest and concern to us, and we would be loath to take any action which would have a substantial adverse impact upon fleet quality. We do not believe, however, on the basis of the facts developed in this record, that an eighty-five bus purchase program and a fourteen year depreciation life would cause a substantial deterioration in fleet quality. It would, on the other hand, relieve the ratepayer of a considerable financial burden at a time when other burdens, particularly the labor costs of the company, are increasing significantly. Weighing all factors involved, we conclude that the wise course is to order a change in depreciation life from twelve to fourteen years and a change in the annual bus purchase program from one hundred new buses per year to eighty-five new buses per year. The projection for depreciation expense shown in the operating statement for the future annual period without a fare increase, supra, was based on calculations by the staff of the Commission working from the unrecovered cost of buses as of October 31, 1967, per company books; depreciation expense for the future annual period, for buses, was then calculated on a fourteen year service life basis with 4% of the original cost of each bus treated as residual salvage value. This treatment was accorded all new buses purchased since 1956; other rates of depreciation, previously set by this Commission for minibuses, second-hand buses, and buses acquired prior to 1956, remained unchanged.

The decision to shift to a fourteen year life does not conclude our discussion of depreciation. Certain other adjustments are in dispute and must be dealt with. The staff proposed disallowance of \$113,196 of the depreciation expense projected by the company. This amount is attributable to a projected loss on a proposed sale in the future of certain buses

presently owned by the company. To allow this item, we would have to assume, first, that the company will sell these buses; and second, that the loss will be in the amount projected by the company. This is too highly speculative an item and has certainly not been established by the evidence presented by the company. We will disallow this expense.

The staff also suggested that we disallow depreciation expense of \$55,288, attributable to depreciation on twenty over-the-road buses now owned by the company. The staff states that the company plans to sell these buses shortly and that depreciation on them should therefore be disallowed. The company agrees to part of this disallowance, namely \$26,217, since it concedes that it has sold ten of these buses. It will not agree as to the remaining \$29,071, however. We accept the company's contention. We do not think it proper to assume that all these buses will be sold in face of the company's representation to the contrary.

It was also suggested by the staff that we disallow an additional \$77,720 of the company's projected depreciation expense. This is the amount of expense sought in the future annual period for depreciation on eighty new buses the company planned to purchase by June 1, 1968. The staff argues that because the company failed to purchase the one hundred buses allowed for in the last rate case, we should not assume that the new bus purchases called for by this order will be made.

It is true that the company did not purchase one hundred buses, as allowed for in the last rate case and, as discussed below, we will make an appropriate adjustment to reflect that fact. It does not follow, however, that we should disallow the expense attributable to the new bus purchases this year. It seems a dubious course to disallow an expense on the assumption that a Commission order will not be complied with. Nor is it naive to assume compliance. The company has represented to us that the purchase will be made. Moreover, its cash working capital position has been improved as previously described so that the means for compliance exist.

We will, of course, take the steps which prudence dictates on the basis of our experience last year. Specifically, our order will require certain reports by the company to keep us informed of their actions in compliance with the bus purchase order. We will order the company to purchase 85 new buses, constituting approximately 1/14th of its current bus fleet; we will require the company to present proof to this Commission that a firm order for 85 new transit-type buses has been placed with a recognized supplier on or before February 1, 1968, at which time the company will be authorized to begin accruing for depreciation on its bus fleet (buses acquired since 1956) at the rate of 6.8571% per annum (14 year life less 4% residual). The placement of the bus order on February 1, 1968, will provide the usual four-month lead time for delivery of the buses so that they may be placed in service by June 1, 1968.

We will, therefore, allow as an expense in the future annual period the depreciation accrual on 85 new buses, beginning June 1, 1968, in the amount of \$82,577.50.

One additional item relating to depreciation requires our attention. We have alluded several times previously to the fact that in the last rate case our computation of revenue requirement contained, among other items, an amount of depreciation expense attributable to the projected purchase by D. C. Transit of one hundred buses in the year ending June 1, 1967. In fact, no buses were purchased in that period although twenty-five buses were ordered shortly after June 1 and were delivered in November, 1967. In the months since the fare increase, which was based in part on the assumption of a one hundred bus purchase, the company has earned at, or above the rate of return we authorized in that order. Hence, the ratepayer has provided the company with funds designed, in part, to provide an improvement in service which has not in fact materialized. We feel that an appropriate adjustment should be made to retain for the ratepayer the benefit he has bestowed upon the company.

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In considering what kind of adjustment to make, we have been mindful of our growing interest, and that of the riding public, in effecting service improvements. We have recently directed D. C. Transit, as well as all other regular route carriers subject to our jurisdiction, to file reports with us which spell out steps designed to deal with certain specific service problems. We are very much aware that when the time comes for action on these problems, we will be faced with the fact that attempts at improvement may require activities involving expenses greater than the income they produce. In the past, this has been a deterrent to action by the company.

With these thoughts in mind, we see a beneficial means of recouping for the ratepayer the revenues paid in for depreciation expense on a bus purchase which never materialized. We will direct the company to establish a fund in the amount of \$141,674. This sum represents depreciation on 100 new buses for the period June 1, 1967 through December 31, 1967, less depreciation attributable to 25 new buses for the months of November and December 1967.



This reserve, or riders' fund, will be expended by the company, as the Commission directs, in such service improvement projects as the Commission deems appropriate. By this means, the rider will obtain service benefits for the revenues paid in for an assumed bus purchase which did not materialize. The benefits will not be those originally envisioned, i.e., addition of new buses to the fleet. They will nonetheless be real benefits, perhaps even more helpful to the riding public.

The above action is to be reflected on the books of the company by concurrent charges, in the amount of \$141,674 to "Special Escrow Fund" and "Surplus" accounts; concurrent contra-credits, in the same amount, will be made to one of the company's working "Cash" accounts, and to the "Reserve for Commission-Directed Projects."

#### The Return to be Allowed

We come now to what is perhaps the most important, and certainly the most complex, problem in the case, i.e., the return to be allowed the company. A significant factor in our consideration of this question is the fact that we addressed ourselves in detail to the matter of rate of return just nine months ago in our Order Nos. 656 and 684, ruling on the last D. C. Transit rate case. We do not imply that our discussion there is dispositive of the issue in the present proceeding. We must decide the question here on the basis of the record now before us. Nevertheless, our statement therein of basic guiding principles continues to be valid and we will repeat it here.

For guidance on the applicable legal principles, we need to look generally to the decision of the Court of Appeals in D. C. Transit System, Inc., v. Washington Metropolitan Area Transit Commission, 350 F.2d 753 (D.C. Cir. 1965) where the court discussed the rate of return question as it applies to D. C. Transit. The court ruled, first, that Transit is not entitled to a guaranteed return of 6.5%, as had been argued in that case.

The court went on to discuss, in detail, the factors to be taken into consideration in determining the proper rate of return. While we must make use of the operating ratio method in determining the rate of return, we must make inquiry into a number of factors. Our objective is to determine a just and reasonable rate, i.e.,

...one that assures that all the enterprise's legitimate expenses will be met, and that enables it to cover interest on its debt, pay dividends sufficient to continue to attract investors, and retain a sufficient surplus to permit it to finance down payments on new equipment and generally to provide both the form and substance of financial strength and stability. D. C. Transit System, Inc., v. WMATC, supra, 350 F.2d at 778.

In making this determination, we must inquire into such matters

...as the capital programs in prospect, what such programs entail in terms of down-payments as well as financing, the cost of borrowing money, working capital needs, the desirable ratio of debt to equity, the incentives required by a stockholder to keep his money in the business and the dividends and growth rates requisite to supply these incentives, the opportunities in these respects provided in comparable businesses, and /the/ related matters...D. C. Transit System, Inc. v. WMATC, supra, 350 F.2d at 779.

Moreover, we must not only make this inquiry but we must spell out our reasoning in some detail. Finally, we must bear in mind not only earnings on investments of comparable risk, but also particular facts and circumstances surrounding this company, such as its future equipment needs and their financial aspects, the company's peculiar capitalization, its earnings history, and its present risk situation in light of that history. In short, it is incumbent upon the Commission to undertake a thorough cost-of-capital study, as such studies have evolved in the regulatory field, in determining the return to be allowed to D. C. Transit.

We heard testimony in this proceeding from two witnesses on the subject of rate of return. The company called Mr. John F. Curtin of Simpson and Curtin, a transportation consultant with long and distinguished experience in the field. The staff presented testimony by Mr. David A. Kosh, a utilities expert and rate of return analyst who also brought to us the benefit of a long and distinguished career in the field. We shall begin with a brief description and summary of the testimony presented by each of these witnesses.

#### Mr. Curtin's Testimony

Mr. John F. Curtin presented testimony and exhibits reflecting his determination of the fair return to be allowed the company. Mr. Curtin stated it was his opinion that the determination of a fair rate of return

requires consideration of the amount needed by the company to safeguard its service, to attract capital and to provide sufficient income, over and above operating expenses, to insure the financial soundness of the company, after giving due consideration to the inherent differences between the transit industry and other businesses, including other utilities as well as other industries generally.

He enumerated seven economic factors by which the transit industry may be distinguished from other industries. In his opinion they represent risk factors over and above those in other industries which make Transit's securities more speculative. It was Mr. Curtin's opinion that this company is a typical transit utility with operating characteristics similar to transit systems throughout the United States; the similarity embraced such factors as the trend of its patronage, the population of its service area, and in the relative degree of use of transit within the community.

Mr. Curtin presented tabulations showing the operating ratios of public utilities in the Washington area for a period of 12 years, of railroad companies throughout the United States for a similar period, and of a group of privately owned transit systems over a two year period, which, in his opinion, were a representative group. Mr. Curtin compared the growth of the utilities in the Washington area with the growth of the company and concluded that D. C. Transit does not have the same growth characteristics as the other local utilities; accordingly, he concluded that the transit company was not able to absorb the rising costs due to the areawide inflationary pressures.

Mr. Curtin also discussed the risks inherent in the transit business from the long-term viewpoint, and discussed the long-term growth of public utilities. This witness recognized that the company's passenger volume trend has actually increased in the past few years. However, he classified this as a minor change and contrasted it with what he noted was a strong growth trend existing among other major utilities of the metropolitan area.

The witness also made a comparative analysis of the quality of public utility bonds and notes, comparing Transit with other utilities. Mr. Curtin also presented a comparative analysis of the company with other transit systems insofar as their basic market characteristics were concerned. He concluded that Washington is reasonably representative of the major metropolitan areas in this country, both in terms of city and urban population density.

The witness presented a comparative analysis of operating revenues, operating costs, wages and salaries, and miles of service for the company in the years 1961 through 1966.

Mr. Curtin recommended that this company should earn a return, as a minimum, in the amount of \$2,600,000 annually. In arriving at this conclusion, the witness commingled what is known as the "comparable earnings"

standard and the "attraction of capital" standard. To this end, Mr. Curtin presented the capitalization of various public utility groups in 1966, including electric, gas, telephone, water and transit. He tabulated the comparative price of debt capital among those public utility groups, again in 1966, and then gave his analysis of the tabulation. Correspondingly, he presented a comparison and analysis of the price of equity capital among that same group for the same year. That was followed by a comparison of the price of debt and equity capital among the same group, which was followed by a synopsis of the total return on capital, on a comparable basis for the same groups of utilities. Mr. Curtin concluded from this analysis that whereas the money market was willing to invest in other utilities which return yields between 5.7% and 7%, investors in the transit industry required a return of 10.1%. In arriving at his conclusion that Transit should be permitted a return of 2.6 million dollars annually, his recommendation was based on three general factors: (1) rate of return; (2) operating ratio; (3) adequate coverage on the existing and anticipated debt.

In deriving a rate of return of 9-1/2 to 10%, Mr. Curtin took the average return on market valuation of all securities for his group of 12 transit companies. He computed that this return was 10.1% (Table X). However, since D. C. Transit stock is held exclusively by a parent company, there is no market appraisal available for the system. Mr. Curtin took the view, however, that since the risks borne by D. C. Transit is comparable to that of other large city operations -- i.e., the 12 transit companies considered in deriving the average return on market valuation, a similar return should be afforded D. C. Transit. In the absence of a current appraisal or market valuation of the securities of the company, Mr. Curtin related the return of 10% to Transit's weighted average rate base, which he computed to be \$27,162,727. The \$2,600,000 recommended return equates to 9.57% of that rate base. In this witness's opinion, this is a minimum return because he felt a market appraisal of the property would reflect a value higher than his stated weighted rate base.

Mr. Curtin then derived what in his opinion was a proper operating ratio for the company. He concluded that the short term risk exposure of the company required an operating ratio in the range of 92.0% to 92.5%. That operating ratio was a judgment figure arrived at by weighing various factors, including the attraction of capital, the vicissitudes of the transit business, and a comparison of the operating ratio of D. C. Transit with that of local electric, gas, and telephone companies. He noted that the recommended return for the company under the operating ratio method was considerably less than the margin which other utilities in the metropolitan area normally enjoy.

He concluded that a return of 7.5% to 8.0% on anticipated revenues of \$39,767,548 would produce a margin between \$2,982,600 and \$3,181,400. However, the recommended return of \$2,600,000 was equated by him to 6.54% of operating revenues.

The third consideration advanced by the witness to support his recommended return was an analysis of the debt requirements of the company and the need to provide adequate coverage thereof.

The witness testified that the aggregate outstanding debt on May 31, 1967, amounted to \$21,838,205. The weighted average interest rate on this debt at that time was 5.95%. Moreover, the witness contended that the cost of debt money has been rising for the company, noting that recent financing has required interest rates of 6-1/2 to 7%.

Finally, the witness stated that the return would provide a return on equity capital of \$1,366,200, or a 32.29% return on the book equity value of the company. He indicated, however, that the percent return based on book value equity has no significance because, in his opinion, the book value equity of the company bears no meaningful relationship to the market value of the company. Accordingly, the actual return on market value equity would be at a rate less than 32%.

#### Testimony of David A. Kosh

Pursuant to our directive, the staff engaged an independent expert in the field of rate of return. Mr. David A. Kosh, of the firm of Kosh, Glassman Associates, public utility consultants, presented testimony and exhibits reflecting his opinion as to the return to be allowed the company in this proceeding.

Mr. Kosh approached his problem from two points of view -- the classic rate of return on rate base, and the operating ratio. In laying the foundation for his recommendations, Mr. Kosh noted that prices in general were set by the forces of price competition; where businesses vested with the public interest exist without competition, the substitute for competition is regulation. He noted, however, that regulation must make it possible for the utility to compete in the capital markets for the funds it needs. The utility's earnings, both historical and prospective, must be sufficient to maintain existing capital and attract the required additional capital on reasonable terms. Mr. Kosh concluded that the fair return should be identified with the price a utility must pay, that is, the earnings it must hold out to attract capital. He concluded that the basic ingredient of a fair rate of return is the cost of capital. He declared that the cost of capital is determined by considering the pure rate of interest and the compensation for subjecting one's capital to uncertainty, i.e., the degree of risk.

Mr. Kosh stated that where a company's securities are actively traded, the terms on which it is traded provide evidence of the cost of that

particular type of capital to that company; accordingly, the yields of a company's bonds reflect cost of debt, and the earnings/price ratios indicate the cost of equity.

In effect, Mr. Kosh stated that the fair rate of return is basically equal to the cost of capital, and that the cost of capital is determined in the investment markets. Contrary to the position taken by Mr. Curtin, Mr. Kosh declared that the capital structure of a company affects both the cost of debt and the cost of equity.

Since the securities of D. C. Transit are not traded, Mr. Kosh obtained evidence as to the cost of capital to D. C. Transit by relying upon an analysis of a group of transit companies whose securities were traded and, in his opinion, very similar to Transit.

Mr. Kosh then developed his second approach, that is a determination of the operating ratio or revenue margin. He explained that the operating ratio is the ratio of all expenses, including depreciation and all taxes, to revenue. The reciprocal of that ratio equals the margin of return or revenue margin. It is Mr. Kosh's opinion that it is improper to compare the operating ratios of non-transit industries with the transit industry. He noted that the so-called standard utilities require a heavier investment per dollar of revenue than do transit companies. Accordingly, the margin between revenues and expenses is much greater than it is for transit companies. It is the greater variability of earnings, combined with low-profit margin, stated the witness, which makes the revenue margin a matter of much greater import in the transportation utilities than in the standard utilities. Mr. Kosh concluded that the equity holder in transit companies then is much more concerned with the fluctuations in revenue margin than in the return on investment. In seeking to determine the capital requirements of a transit company then, the regulator should seek a relationship for the transit industry against which it could measure the fluctuations in earnings of a given company.

After laying down those general rules, Mr. Kosh attempted to measure the cost of equity in general. He did so by determining earnings/price ratios for a general group of utilities, over an extended period of years. Mr. Kosh stated that an evaluation of earnings/price ratios must be made over an extended period of time during which abnormal short run pressures tend to balance out. In his opinion, the years 1958 to 1966 provided such a period. He noted that because the stock of D. C. Transit was not traded he was unable to determine earnings/price ratios for that company. Therefore, in order to get a base for his estimate of the cost of equity to D. C. Transit, he selected a group of transit companies which he felt were representative of the industry and comparable to D. C. Transit at the

same time. He also explained the basis for eliminating certain companies. For example, he stated he had eliminated all holding companies, all interstate long haul companies, and all wholly owned subsidiaries which had no stock traded. He also eliminated companies with a relatively small number of stockholders and also those companies that did not pay dividends during each year of the period 1958 to 1966 inclusive. After selecting nine companies, he developed comparisons among them and with Transit, noting their general operating characteristics, density of population, employees per bus, and revenue passengers per bus per day.

He further presented a summary of his analysis of the nine-company transit group and applicant herein, showing for each its operating ratio, revenue margin, and the standard deviation of the margin (that is, a measure of the scatter or dispersion of the individual annual values around the average). Also, he showed the net plant turnover, the rate earned on net plant, the average earnings/price ratio, the dividend payout ratio, the equity ratio, and the ratio of market price of the stock to its book value. Mr. Kosh stated that it was his opinion that the nine companies he selected reflect an investment opportunity similar to that of D. C. Transit, if the companies are considered as a group and not on an individual basis.

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Mr. Kosh then made a study to determine to what extent the earning/price ratios reacted to different degrees of fluctuations in the revenue margin. He did this to test the hypothesis that investors would require a higher return, for transit companies whose revenue margins or earnings fluctuated greatly than for those whose revenue margins were more stable. The test was made by developing an index or measure of variability by establishing a ratio of the standard deviation divided by the average revenue margin. (Exh. 42, pp. 7-9). His test revealed that the computed earnings/price ratio was 12.62%. Having established a 13% return on equity based on the above earnings/price ratio analysis, the witness increased the cost of equity to 15%, based on an additional allowance for the cost of financing and other factors involved in raising equity capital. The witness then developed D. C. Transit's cost of debt, which, based on his analysis, was 5.98% as of December 31, 1966, and which would be increased in 1967. The witness stated that the cost of anticipated new debt would be 7.5%; accordingly, the cost of debt to the company as of December 31, 1967, would average out to 6.32%.

Having derived the cost of debt and the cost of equity, the witness developed two capital structures. The first was the actual capital

structure as of December 31, 1966, and the second was a pro forma capital structure as of December 31, 1967. He noted that the actual capital structure as of December 31, 1966, consisted of 87% debt at a cost of 5.98% and 13% common equity, for which he used a cost of 15%. The total cost of capital for the actual period was 7.15%. Using the pro forma capital structure, he established debt at 86% at a cost of 6.32%. He then derived 14% of common equity at a cost of 15%. As a total cost, he computed the figure of 7.54%. These two percentages he stated were the cost of capital. Based on those costs, it was his opinion that a fair rate of return on rate base for the company at this time was 7-3/4%.

Mr. Kosh's approach to forming an opinion as to the proper earnings to be allowed under the operating ratio method was derived through an analysis of the variability or fluctuations of the revenue margin of Transit as well as the group of the nine transit companies previously discussed. Mr. Kosh found that the average margin for the group of transit companies was 4.12%. The standard deviation developed was 1.16%.

A parallel computation for D. C. Transit was derived and showed an ~~average revenue margin for the nine year period of 4.15% with a standard~~ deviation of 1.18%. Mr. Kosh then related that had the company earned a revenue margin of 4.15% (its 1958-1966 average) in 1966, its revenue margin would have been \$1,434,000. At the end of 1966, interest requirements were \$1,294,000; earnings thereby covered interest 1.1 times, which Mr. Kosh considered barely sufficient.

He noted, however, that there is a 1 in 3 chance that earnings would decline to a 2.97% revenue margin, that is, a deduction by one standard deviation of 1.18%. At this level earnings would clearly be insufficient. Mr. Kosh then recommended that Transit be allowed a revenue margin of one standard deviation above its average, that is a margin of 5.3%. Such a margin, he stated, provides a sufficient safety factor against chance occurrences.



We have, then, on the one hand, a recommendation by Mr. Curtin that we allow the company a rate of return on gross operating revenues of 6.54%, or, in dollar terms, a return of \$2,600,000 annually. We will address ourselves, first, to whether we can accept this recommendation.

Mr. Curtin's recommendation was, as any rate of return determination must be, an expression of his best judgment as to the return required by the company. He based this judgment upon an analysis of certain data he presented to the Commission -- an analysis which was, in essence, the comparable earnings approach to rate of return determination. He further supported his judgment by an analysis of the return he recommended in terms of the criteria set out by the court of appeals in D. C. Transit v. WMATC, *supra*, p. 25.

We are not persuaded by Mr. Curtin's reasoning, however. He first presented us with a comparison of data relating to D. C. Transit and certain other transit companies with other data relating to certain groups of companies from traditional utility fields such as gas, electric and telephone. These data covered both operating ratio and return on market valuation of capital. He concluded that the transit industry data differed significantly from data as to other utility industries, a fact which we do not doubt but which gives us little specific guidance as to the significance of the data concerning other industries, or as to the return which should be allowed to D. C. Transit. He further contended that the risk borne by D. C. Transit was comparable to that of other large-city transit operations. This conclusion was based on the broadest of data and not on any detailed analysis as to the comparability with D. C. Transit of the specific companies concerning which he presented information.

More significantly, in reaching this conclusion, there was no discussion of certain particular facts concerning D. C. Transit which, as we have previously stated in Order No. 656, should be considered in assessing risk. To repeat again our language there, we are interested in Transit's position in a complex corporate structure. It is a subsidiary of an enterprise having a variety of activities. The parent company, in turn, has a number of subsidiaries engaged in non-transit activities such as real estate and broadcasting. We are fully aware that what we are regulating is the company's transit operation and, in mentioning these other factors, we do not assert any jurisdiction or control over them. However, we are not considering the abstract question of what return should be allowed to a theoretical transit operation. We are trying to determine the return to be allowed to Transit. This requires an assessment of the cost of capital to this particular company, and that cost, from the viewpoint of an investor, would be determined not merely by the risk involved in the transit operation, but by the overall prospects of the company in all its endeavors. Further in this connection, we are given no help on how the

risk factor for Transit is affected by future prospects for development of real estate still held by Transit but which might be developed in other ways. We are not asserting that such prospects exist but we are interested in evidence or discussion of the question. Finally, we find nothing on how the risk factor and, therefore, the cost of capital, is affected by the company's past financial history.

In any event, Mr. Curtin eventually sets forth the conclusion that in 1966 the return on market valuation of the capital of his group of 12 transit companies is 10.1%. This is, of course, an average. Turning then to D. C. Transit, he points out that his recommended return of \$2,600,000 is equal to 9.57% of the company's historical cost rate base. He pointed out this percentage relationship because he has no figure for D. C. Transit directly comparable to the market valuation of capital used for his other companies since D. C. Transit's stock is not traded. We expressed our concern that Mr. Curtin was not comparing likes with likes, and, at our request, Mr. Curtin subsequently supplied the 1966 return on historical cost rate base for each of the twelve companies he used for comparison. Examination of that data shows that 6 of the companies had a return on historical cost rate base lower than that he recommends for D. C. Transit. Moreover, one of the six companies with a higher return than his recommended level was Cincinnati Transit Company. It was revealed on the record that this company's net income in 1966 was distorted to an unusually high level by a non-recurring income from profit on the sale of securities. This not only renders its 1966 return of no value for comparison, it distorts the entire average. Further, this fact illustrates the danger of relying upon data as to a single year in reaching conclusions on return. In short, we find little to rely on in the data he presented to justify a conclusion that a return on rate base in the neighborhood of 10% is proper.

Mr. Curtin also analyzed his recommended return in terms of operating ratio. He opined that a return of 7.5% to 8% on gross operating revenues (i.e., an operating ratio of 92% to 92.5%) was appropriate. It was rather vague as to how Mr. Curtin arrived at this conclusion. In stating it, he did not compare this figure with data for other companies, as he had done in discussing return on market valuation of capital and return on rate base. At our request, however, Mr. Curtin supplied the operating ratios experience in the seven years from 1960 to 1966 by the twelve transit companies he used for comparative purposes. This gave us a total of eighty-four separate instances of operating ratio experiences. It is interesting to note that only in seven out of these eighty-four instances was an operating ratio as low as that recommended by Mr. Curtin experienced. No company listed experienced a consistent pattern of operating ratio at the level urged by Mr. Curtin.

Apparently, Mr. Curtin himself did not feel strongly that a return of 7.5% to 8% on gross operating revenues could be justified since the dollar return he actually recommends amounts only to 6.5% of those revenues.

Again we note that, of the eighty-four instances of operating ratio experience supplied by Mr. Curtin at our request, only fourteen were at or higher than a 6.5% return. Only one of the twelve companies consistently obtained such returns. We feel that neither Mr. Curtin's data, nor his reasoning, concerning operating ratio justify the conclusion he recommends.

Mr. Curtin also discussed his suggested return in terms of coverage of debt service. It was his position that debt service, whatever its level, should be covered two times by the authorized return. He cited no experience to justify this conclusion. Nor did he think its application to D. C. Transit should be examined in light of the fact that D. C. Transit's debt-equity structure at May 31, 1967 -- 89% long-term debt and 11% equity (Company Exhibit No. 1) -- was almost precisely the opposite of the typical experience in the transit industry. We simply cannot accept the principle that, whatever the level of debt service imposed upon the company by its management, the return allowed should be twice that amount. This is simply another way of saying that, no matter what the equity investment, the equity holder should receive a return in dollars equal to the amount paid for debt service. We feel that a more cogent analysis on the subject of debt service coverage is needed. We cannot accept Mr. Curtin's reasoning or conclusion.

Finally, Mr. Curtin analyzes his recommended return in light of the factors set forth by the court of appeals in its discussion of return in D. C. Transit System, Inc. v. Washington Metropolitan Area Transit Commission, 350 F. 2d 753 (D.C. Cir. 1965). The elements referred by the court are (1) legitimate expenses; (2) interest on debt; (3) sufficient dividends; (4) sufficient surplus for needed down payments and financial stability. Mr. Curtin breaks down his recommended return as follows:

(1) Interest on debt	\$1,233,800
(2) Dividends on stock	500,000
(3) Down payments on new buses	354,600
(4) Balance of return on equity as retained earnings	<u>511,600</u>
Total	\$2,600,000

This breakdown, says Mr. Curtin, demonstrates that the standards set forth by the court of appeals are met by his recommendation. We do not agree.

We have no problem with the interest element; the amount of interest to be incurred must be covered by the return. However, Company Exhibit No. 33 shows an interest forecast of \$1,244,458. This forecast includes interest on the projected purchase of 80 buses in 1968. Errors in this

Exhibit were corrected in Staff Exhibit S-30 which developed a projected interest cost of \$1,162,490 for the future annual period. This latter figure failed to include a provision for interest on the financing of new buses in 1968. So the amount of \$70,453 should be added to provide 6-1/2% financing on 85 buses, assuming a 10% down payment. This brings the total interest forecast to \$1,232,943. This total is higher than it might otherwise be because it includes interest on 16 short-term notes created by the cash shortage mentioned supra; the interest on these latter notes total some \$180,000.

Mr. Curtin then postulates that \$500,000 must be allowed in the return element for dividends. He bases this assumption on investor expectation based on past experience. In essence, he says, the \$500,000 dividend paid in the past must be continued. This reasoning ignores the fact that no dividends have been paid since July, 1966, and that investor expectations cannot be assumed to be unchanged. Moreover, Mr. Curtin agreed with us on cross-examination that, if we concluded that the amount of dividends allowed for in the past was no longer appropriate, we were free to change that allowance.

We considered the question of dividends just nine months ago in our Order No. 684 and our discussion there, which is still pertinent and still represents our view, will be repeated in pertinent part here. We do not consider it our province to dictate the amount of dividends which should be paid. Rather, we should permit a return which will ~~allow the management of the company to pay a sufficient dividend to~~ compete in the capital markets. We do not anticipate that the entire amount of net cash flow would be used for dividends, however, because of the company's recent cash history.

We anticipate, therefore, that dividends, if declared, will be at a level significantly lower than in some past years. We do not regard this as requiring a larger return. The substantial risks the company faced in coming into this community at a difficult time and converting to an all-bus operation with a high standard of service may well have dictated a high return of capital in past years. As we look at the company now, however, it faces a more secure future than most transit companies, having a modest but definite growth potential.

We have problems with the remaining two items in Mr. Curtin's breakdown. First, we believe that the separation he makes between down payments and retained earnings is questionable. Down payments on buses are a cash requirement which comes out of the cash flow of the company. They are not credited against surplus, nor do they affect the "surplus" or "retained earnings" in any way. In reality, Mr. Curtin's two items should be added together and amount to a recommendation that we should allow a growth in retained earnings of \$866,000 annually, after dividends of \$500,000. Based on the company's retained earnings at the end of the historical period in the amount of \$2,261,544, the addition to retained earnings, before dividends, i.e., \$1,366,000 represents a growth rate for retained earnings of 60%. Assuming a dividend payout in the amount allowed for by Mr. Curtin, the actual amount retained in surplus would be \$866,000, representing a growth rate of 38%. As we stated in Order No. 684, we

believe we should allow for growth in retained earnings, but the rate recommended by Mr. Curtin is, in our judgment, immoderate.

We might add that, while the growth in retained earnings should be related in some measure to the need for additional capital expenditures in the business, we do not feel that all additional equity capital requirements should be furnished through retained earnings. This, however, is the assumption underlying Mr. Curtin's contention that the entire down payment requirement for new buses should be allowed for in the return element. Certainly, some capital growth should be internally generated, but we do not need to protect the equity holder from the need to produce additional equity capital from outside sources.

In sum, therefore, we do not believe that the company has established a need for a 6.5% return on gross operating revenues. We are not convinced, either by Mr. Curtin's reasoning or by his supporting data, that this is the level required by application of the comparable earnings test. We do not think his analysis of the dollar amount he recommends in terms of the criteria established by the United States Court of Appeals for the District of Columbia Circuit stands up to scrutiny. We note with disfavor that he has not discussed or taken into account such factors as D. C. Transit's place in a larger corporate structure, its prospects for development of real estate it holds, and its past financial history. For all these reasons, we will not accept Mr. Curtin's recommendation.

Mr. Kosh based his recommendations as to return on a rational and analytical approach to certain basic data concerning both D. C. Transit and other companies, both within the transit industry and in other fields of endeavor. Mr. Kosh approached the problem from two distinct bases. First, he presented an analysis which was essentially a combination of the traditional cost of capital approach to rate of return determination and the comparable earnings approach. In essence, Mr. Kosh undertook to determine the cost of capital to D. C. Transit. While it was possible to make a direct determination of the cost of debt, no such direct approach was possible in the case of the cost of equity. The usual method employed in such determination, at least where market value and book value of equity securities are substantially the same, is to analyze the earnings price ratios. This was not possible in the case of D. C. Transit because the stock of the company is not publicly traded. To overcome this difficulty Mr. Kosh analyzed the earnings price ratios of a group of nine transit companies, which, in his opinion, were comparable to D. C. Transit. He supported this conclusion as to comparability by presenting data concerning the general operating characteristics of each company. The conclusion was that these companies as a group represented an investment opportunity similar to that of D. C. Transit. He then pointed out that the average earnings price ratio for the group was 13.31%.

To further test his analysis of cost of equity capital to D. C. Transit, Mr. Kosh used a second approach. Mr. Kosh attempted to establish a relationship between the earnings price ratio required by investors and the fluctuations in revenue margin, i.e., operating ratio experience of a given company. He plotted the results for the nine companies on a graph which established a relationship between fluctuations in revenue margin and earnings price ratios. He then computed the fluctuations in revenue margin experienced by D. C. Transit and placed this on the curve developed for the other companies to determine what earnings price ratio was indicated. The answer was 12.65%, a figure substantially similar to the conclusion reached by the method previously described.

On the basis of both these analyses Mr. Kosh concluded preliminarily that the cost of equity capital to D. C. Transit was 13%. In a final adjustment, he increased this figure to a 15% cost of equity. This adjustment was designed to reflect the downward pressure on the market price of stock which would be involved in a new issue thereof and which would therefore increase the earnings price ratio required.

Mr. Kosh then computed the company's cost of debt capital to be 6.32%. Mr. Kosh applied these figures both to the actual capital structure of D. C. Transit and to a pro forma debt structure based on a financial program he himself proposed. ~~The total cost of capital based on the actual~~ debt structure was 7.15%. On the pro forma structure the cost of capital was 7.54%. On the basis of all these figures Mr. Kosh concluded that the return on rate base required by D. C. Transit is 7.75%.

Mr. Kosh then turned to an analysis of the return requirement in terms of operating ratio. His analysis was one which he himself admitted was novel in rate proceedings. He examined the operating ratios experienced by D. C. Transit, and by the same group of nine transit companies referred to previously, over a nine year period. He studied the fluctuations in return experienced by D. C. Transit and the other companies and determined the standard deviation by each company. He found that the average return on revenues for the group was 4.12% and that the standard deviation experienced by the group was 1.16%. For D. C. Transit he determined that the average return on revenue for the nine year period was 4.15% with a standard deviation of 1.18%. According to statistical theory the chances are two out of three that in a given year D. C. Transit will experience a return in the range between 2.97 and 5.33%, i.e., within one standard deviation on either side of the 4.15% average. Mr. Kosh's examination of the interest requirements reveals that a return of 2.97% would not produce enough earnings to cover the interest requirement and, as Mr. Kosh points out, this is obviously inadequate. Hence, Mr. Kosh recommends a rate of 5.33%. In other words, he would recommend a return one standard deviation above the average experienced in the eight year period. This would mean, again according to statistical theory, that the chances are two out of three that in any given year the company would

experience a return not lower than 4.15% and not higher than 6.51%. In one out of three instances the return would fall outside this range but whether on the high or the low side cannot be predicted.

It is interesting to note that according to the statistical theory spelled out by Mr. Kosh, the chances are that in two out of three years the company would have the opportunity to earn as high as 6.5%. This is of interest in light of the language of Section 4 of D. C. Transit's franchise and Article 12, Section 6(a)4 of the Compact. On the basis of this method of analysis Mr. Kosh recommended a return on gross operating revenue for D. C. Transit of 5.3%.

We find his approach interesting. It is, beyond question, a reasoned and rational attempt at analysis of certain data designed to form a basis for a judgment as to proper return to be allowed. We are not unaware, however, that the approach does have flaws. For one thing, it is somewhat too abstract to be fully acceptable. For instance, in essence, Mr. Kosh concerned himself only with a rate of return. He made no recommendation as to a dollar amount of return and this seems to us to be an essential element to the rate of return determination. Moreover, because he did not address himself to the question of a dollar return, Mr. Kosh did not provide, at least as part of his presentation in chief, an analysis of the return recommended in light of the criteria set forth by the United States Court of Appeals for the District of Columbia Circuit in its 1965 D. C. Transit decision. On oral examination, Mr. Kosh did ~~address himself to this question, and he concluded that a return at the~~ level he recommends would meet the Court's criteria.

Finally, we consider it a flaw that Mr. Kosh's analysis did not take into account those facts and circumstances peculiar to D. C. Transit such as its past financial history, its position in a complex corporate structure, and the development value of its real estate. As we stated in discussing Mr. Curtin's testimony, we feel that these are factors which must be considered, if not by rate of return witnesses, by the Commission itself in making its decision.

While we recognize these flaws in Mr. Kosh's analysis, it does not follow that the figure he recommends must be rejected. Mr. Kosh aimed his major thrust at an exceedingly critical area in regulation-by-operating-ratio. Quoting from the decision of the United States Court of Appeals for the District of Columbia Circuit (Case Numbers 17,953 and 17,954, decided April 8, 1965), the Court, on page 9, was discussing the reason for reliance upon the operating ratio method of ratemaking in the case of motor carriers, and stated: "The principal risk in such operations inheres in the cost of operation, not in the investment." Mr. Kosh attempted to quantify this risk as pinpointed by the Court. By studying the behavior of operating ratios, or its reciprocal -- margin on gross revenues -- Mr. Kosh was able to provide an empirical formula as a basis for the exercise of judgment as to what constitutes a fair and proper rate of return on gross operating revenues.

We have computed the return called for by a conclusion that a 5.33% return on gross operating revenues is fair and proper. That return would amount to about \$2,000,000. Analysis of such an allowance indicates that it is fair and reasonable to the company. In these circumstances it is proper for us to adopt this end result. F.P.C. v. Hope Natural Gas Company, 320 U.S. 591, 602 (1944).

In terms of return on system rate base, a net operating income of about \$2,000,000 will represent a return of about 7.4%. We have not concerned ourselves too much with an exact rate base because, in the case of this applicant, this is not a sensitive figure. The rate base relied upon by Mr. Curtin for the company was \$27,162,727, a projected rate base; this was very close to the historical average rate base developed by the staff in Exhibit S-43, as of October 31, 1967, in the amount of \$27,160,779. In each instance, \$2,000,000 would represent a return of 7.363%. On the other hand, if the staff's figures were projected to October 31, 1968, providing for the purchase of 85 new buses and the accumulation of depreciation, the average rate base for the 12 month period ended October 31, 1968, would stand at \$26,725,442, against which a return of \$2,000,000 would represent a return of 7.483%.

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The net operating income of about \$2,000,000, when related to capitalization of D. C. Transit as of May 31, 1967 equals 8.04% (on long-term debt and stockholder's equity per Staff Exhibit S-19); and the net income available to the equity holders (after interest) is 26.4% of equity as of May 31, 1967 (Staff Exhibit S-19). This return will allow debt service coverage of 1.62 times. We are not allowing interest requirements to be covered two times as suggested by Mr. Curtin, but only 1.6 times. As we stated in discussing Mr. Curtin's testimony, we think the suggested factor of two, for coverage of interest, is excessive in light of the company's capital structure. The coverage we have allowed does not unduly burden the rate-payer and yet amply protects the company's ability to service its debt.

We have measured our tentative operating margin of 5.33% against the margins experienced by the companies studied by the two consultants in this case. Mr. Curtin's 12 companies (Exhibit 28H) showed, after converting his operating ratio figures, that the return on gross operating revenues for the one year studied by Mr. Curtin (1966), ranged from 2.94% to 8.17%; he did not develop an overall average. Mr. Kosh, on the other hand, presented the picture of 9 companies, giving effect to their experience over the years 1958 through 1966 (Exhibit S-42). The range for these companies was 2.27% to 6.35%, with the arithmetic average being 4.12%. The same exhibit showed an average rate of return on net plant of 7.94%, with a range of 3.49% to 11.62%. Mr. Curtin's return on rate base study appeared on Exhibit 28G, and developed an average of 12.37%, with the range beginning at 5.30% and reaching a high of 30.50%. As noted in the record, and previously in this order, the rate of 30.50%, when adjusted for a non-recurring profit on sale of securities, became 7.5%.



The return of approximately \$2,000,000, considered in this case as fair, fits comfortably within the parameters set in the exhibits presented by the consultants, equating to 5.3% or 5.4% of gross operating revenues and about 7.4% on average rate base.

We have considered the return allowed in light of the criteria spelled out by the court of appeals. From the \$2,000,000 allowed, \$1,232,943 will be paid out in interest. This leaves approximately \$767,000 to be returned to the equity holder. We must consider whether this is adequate to "pay dividends sufficient to attract investors, and retain a sufficient surplus to permit it to finance new equipment and generally to provide both the form and substance of financial strength and stability." D. C. Transit System, Inc. v. Washington Metropolitan Area Transit Commission, 350 F. 2d 753 (D. C. Cir. 1965). We think this requirement is satisfied. A return to equity of this magnitude should permit some payment of dividends, albeit perhaps not at the level experienced by the company in prior years, particularly, in light of the company's need for cash working capital. We do not intend to dictate the amount of dividends to be paid since that is the province of management. However, as previously pointed out, we are not disturbed by the fact that dividends may be lower than past years since we feel that the company faces a more secure future now than it did in the early years when it was coming into the community and converting to an all-bus operation. The amount we allow will provide the equity holders with a rate of return on the book value of equity capital of about 26.4%. We do not regard this as excessive in light of the risks borne by the equity holders and the capital structure of the company.

We cannot predict what growth rate in retained earnings will be experienced since we do not attempt to dictate the amount of dividends to be paid. However, we note that the maximum growth rate in retained earnings, if no dividends are paid, will be 32%. We feel that this permits the growth in retained earnings which is essential for any financially healthy company.

We have also considered both the dollar amount of the return and the rate of return we allow here in the light of our determinations in the last rate case, decided just nine months ago. There, we allowed a rate of return of 5.24%, slightly under the allowance we have determined upon here. We think that this slight increase is justified by general economic developments of which we take note, such as a general increase in the cost of debt capital over the past year. The dollar amount of return we allow here is generally consistent with that allowed in the past rate case, as we feel it should be in light of the proximity of the cases to one another in time.

To sum up on the question of return, it is our judgment, on the basis of the record in this proceeding, that the company must be allowed a net operating income of about \$2,000,000. This dollar return is based upon a

rate of return on gross operating revenues of 5.33%. While this was the figure recommended by the staff witness, we did not adopt it simply because we accept his reasoning. Rather, we have tested the return called for by application of this amount and find that in light of the risks faced by the company, the experience of other transit companies, and the financial requirements of the company, the return allowed seems fair and reasonable. We are unable to accept the recommendation of the company's witness. We feel that neither the data he presented nor the analysis he made of it justified a return of the level he suggests. The return we here allow, in our judgment, meets the standards by which a reasonable return is to be determined.

The contention was raised in this case, as it has been raised repeatedly in the past, that the equity owners of this company have been unjustly enriched at the expense of the ratepayer. This is a contention which has received our careful attention on many occasions. At our direction, the staff has placed detailed data in the record, not only in this case but in past rate cases, as to the financial history of this company and the returns it has produced for its owners. We do not propose at this juncture to engage in a detailed discussion of past history nor to treat analyses of that history which are certainly subject to argument. We think it might be appropriate to point out, however, that of the \$338,391,456 of gross operating revenues which have been paid into the company since its present ownership assumed control on August 15, 1956, \$13,271,341 has flowed through ~~to the equity holders in the form of net operating income, a margin, or~~ return, on gross operating revenues of 3.92%. After deducting interest payments during this period of time, in the total sum of \$7,246,687, the return on gross operating revenues flowing onto the equity holders was 1.78%. Hence, whatever the merits of the arguments on the degree to which the owners have profited, it seems clear that the public has not been unduly burdened.

In the context of our obligations in this proceeding, these arguments of past history are unavailing. We mention them only because a proposal was made in this proceeding that we should, on the basis of this past history, roll fares back to the level at which they were in 1956. We have considered the arguments made along these lines very carefully and seriously. Our obligation, clearly fixed by law, is to establish a rate structure which will produce revenue sufficient to cover the company's expenses and provide it with a fair return.

"Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment. This is so well settled by numerous decisions of this Court that citation of the cases is scarcely necessary." Bluefield Water Works and Improvement Co. v. West Virginia Public Service Commission, 262 U.S. 679, 690 (1923).

Not a shred of evidence was produced to support a conclusion that the roll-back suggested would achieve this result and it flies in the face of common sense to think that it would. Rather than becoming mired in these fruitless arguments over the past, we have faced up to what is our real task in this proceeding. We have rigorously examined the company's expenses to be sure that only those both justifiable and predictable are allowed. We have long and carefully considered the return which should be allowed the company and have reached a figure which, we are convinced, is fair both to the company and to the ratepayer.

We have previously determined that the present fares will produce a net operating income in the future annual period of \$1,544,246, after taxes; this is an operating ratio of 95.82% or a margin of return of 4.18%. See Table I, p. 6.

We have further found that the company is entitled to a revenue margin of about 5.33%, or a net operating income of approximately \$2,000,000. Accordingly, it stands that the existing fares are unjust and unreasonable, in that they will not produce revenues sufficient to enable the company to meet its expenses and earn a reasonable return.

#### Return Projected Under Fares Proposed by the Applicant

Having found that the present fares are not fair and reasonable, we turn to a consideration of the company's proposed fares.

The company originally predicted that its proposed fares would generate \$39,792,162 in gross revenues, which, after application of estimated operating revenue deductions, would produce \$2,586,291 in net operating income and an operating ratio of 93.50%. Subsequently, this prediction was modified by the company; its revised estimate was \$39,901,947 in gross revenues, a net operating income of \$2,593,627 and a 93.50% operating ratio.

Based upon our findings, however, a recasting of results under the proposed fares produces the following income statement:

TABLE II

#### Operating Revenues:

Passenger Revenue (Co. Exh. 4, Sched. 1)	\$ 37,402,453
Charter (Staff Exh. 31)	2,229,650
Government (Staff Exh. 31)	127,790
Limousine (Staff Exh. 31)	--
Station and Vehicle (Staff Exh. 31)	169,153
Other (Staff Exh. 31)	76,255
Total	<u>\$ 40,005,301</u>

Operating Revenue Deductions:

Operating Expenses	\$ 31,997,863
Taxes, Other than Income Taxes	1,839,753
Income Taxes	1,278,788
Depreciation	2,394,647
Commission Directed Credits	--
Amortization of the Acquisition Adjustment	(194,516)
Total	<u>\$ 37,316,535</u>
Net Operating Income	<u>\$ 2,688,766</u>
Rate of Return	6.72%
Operating Ratio	93.28%

The revenues were computed using a .328% resistance factor. Since we have found that a .25% factor is proper in estimating revenues from increased fares, the passenger revenue is thus understated. Accordingly, the net operating revenue is depressed proportionately. However, even using the company's passenger revenue estimates the return which Transit would earn would substantially exceed the amount we have found to be proper. We find, therefore, that the proposed fares would be unjust and unreasonable.

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Rate Structure Required to Earn Fair Return

In order to raise the net operating income by approximately one-half million dollars, additional revenues of \$900,000 to \$1,000,000 must be generated. Our remaining task then is to prescribe a fare structure which will generate the increased revenues, but at the same time be neither unduly preferential nor discriminatory either between riders or sections of the Metropolitan District. At the same time, we must give consideration to the effect of the prescribed rates upon the movement of traffic.

At the outset, we will consider the request of D. C. Transit to discontinue the use of interline tickets.

Shortly after the creation of this Commission, the regular route carriers were requested to devise an interline arrangement whereby a passenger could ride on the lines of two or more carriers by the payment of one fare. The four carriers worked out what is officially known as the interline ticket, and each carrier filed tariffs, with concurrences filed by the other carriers, formally proposing the establishment of this arrangement. Order No. 59, served September 7, 1961, accepted the carriers' plan and authorized a 35¢ interline fare ticket, the proceeds of which were to be divided equally among the participating carriers. Since then, additional charges have been permitted individual carriers (including Transit), in which there was no sharing of the proceeds of the additional charge.

In this proceeding, D. C. Transit filed supplemental tariffs which would cancel the interline agreements and do away with the interline ticket arrangement. The reason given by the Company for its proposal is the allegation that the subsequent changes in price have been confusing to the fare-paying public. It appears from the testimony that the principal reason for the company seeking to discontinue the use of the interline ticket is the fact that it is not getting an adequate distribution from the proceeds of the ticket. The evidence further reveals that the division of the revenues was not dictated by the Commission, but resulted from a voluntary agreement among the companies. The company admitted that prior to filing its request to discontinue the interline ticket arrangement in this case, it made no attempt to meet with the other carriers and seek a revised distribution of the proceeds of the tickets. The interline ticket arrangement has been widely accepted by transit riders in the Metropolitan Area, and they have come to depend upon its availability.

A. B. & W. Transit Company, one of the regular route carriers involved in the interline ticket arrangement, formally objected to the discontinuance thereof, contending that Transit should not be permitted to discontinue the arrangement ex parte. Rather, A. B. & W. asserts that a separate proceeding is required in which all the participating carriers are named as respondents and formally made parties to that proceeding. It further asserts that to permit Transit to withdraw unilaterally from the arrangement will in effect eliminate the use of the interline arrangement by the remaining carriers, and the result would be a disruption to, and a change in, the fare structure of the three remaining carriers.

This Commission has previously ruled that any one of the participating carriers may not unilaterally change the basic agreement. (Order No. 312, served September 20, 1963, In the Matter of WMA Transit Company for Authority to Increase Fares). We affirm now that it appears that one of the participating carriers may not unilaterally and ex parte change the basic interline fare arrangement. Moreover, legal considerations aside, we find that the company has not justified its proposal to discontinue the interline arrangement. Accordingly, on the legal basis discussed above and on the facts in this record, we will not permit the company to discontinue the use of the interline ticket; its supplement proposing the same will be rejected and the tariffs authorizing the interline arrangement, including the division of revenues emanating therefrom, will continue in effect. This does not, of course, preclude Transit from seeking a voluntary re-distribution of the proceeds or the instituting of a formal proceeding naming the participating carriers to the arrangement as respondents thereto. However, the changes in fare structure we promulgate will not include any change in the interline ticket.

We will now turn to a discussion of the new fares which will produce the amount of additional revenue needed to afford the company the net operating income to which we have found it is entitled.

During the course of this proceeding, the Commission directed the company and the staff to present recommended changes in the existing fare structure which would produce additional revenues in increments of \$300,000, up to \$2,100,000. In our instructions, we directed that in calculating the increase to be generated by the increased fares, a fare resistance factor of .25% be employed.

We have previously discussed this subject in our consideration of estimating revenues for the future annual period at present fares. Normally, we would expect the resistance factor of .20% to be valid under proposed fares. However, in view of the fact that the fares must be raised again so soon after a previous increase, we feel that more resistance will develop than would otherwise occur. Accordingly, in our opinion, based on all these factors, we estimate that revenues in the future annual period under increased fares will be subject to a resistance of about .25% for each 1% increase in fares. We are confident that the turnover and increase in population, improved service, and the small amount of the fare increase, will tend to keep the resistance below that estimated by the company, below the "averaged" formula of Mr. Curtin -- indeed, at the lower limit of the range of resistance percentages calculated by Mr. Curtin when he used the data of D. C. Transit's last previous rate case.

In compliance with our directive, D. C. Transit proposed ten alternate fare structures (DCT Exh. 54). Two alternates proposed by the company produced revenues which bracket the additional amount of money which we have found must be generated. Its proposal "E" would retain the present fare structure with two exceptions: the cash fare would be increased by 5¢ to 30¢ and the interstate express fare would be increased by 5¢. This proposal would increase revenues by \$910,115.

Its proposal "D" would increase the following fares: cash fare by 5¢ to 30¢, the D. C. token fare by 1/2¢ to 25¢, interstate local ticket by 5¢ to 45¢ for the first zone, a 5¢ increase in the interstate express fare, and a 15¢ increase in the D. C. Stadium fare. This proposal would increase revenues by \$1,285,750.

The staff recommended 12 alternate fare structures pursuant to our directive (Exh. 8-46). Two alternates proposed by the staff produce revenues that bracket the additional amount of money which must be raised. Staff alternate "8" would make the following changes in fares: a 2¢ increase in the cash fare to 27¢; a 1/2¢ increase in token fare to 25¢; a

5¢ increase in the interstate express fares; an increase of 5¢ in the interstate local zones 2 and 3; a 2¢ increase in the Maryland intrastate local zones 1 and 2, a 5¢ increase in zone 3; and a 15¢ increase in the fare to D. C. Stadium. These changes in fares would produce an additional \$1,110,755.

On the other hand, the staff alternate "7" would produce an additional \$982,800 by the following change in fares: increase the D. C. cash fare from 25¢ to 27¢; increase the token fare 1/2¢ to 25¢; increase the interstate express by 5¢; increase the interstate local zones 2 and 3 by 5¢; and increase the D. C. Stadium fare by 15¢.

Transit's existing fare schedule was approved by us in Order No. 684 as one reflecting fair and reasonable fares, which were neither preferential nor discriminatory between riders or sections of the Metropolitan District. We discussed at length in that order why we reached those conclusions. Our guiding principle in the instant case has been to distribute the burden of the latest increase as broadly as possible over the existing fare structure. In light of this principle, we will reject Transit's recommendation of a charge for transfers. We again conclude that in light of the company's present financial needs, and the means available to meet those needs, a charge for transfers would not be appropriate.

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In weighing the alternate fare structures presented by the company and the staff, we have considered the desirability of having a spread between the cash and token fares, and the degree of spread. We have concluded that the nickel difference proposed by the company is too great from a practical standpoint and one which approaches discrimination from a legalistic viewpoint. We feel that staff alternate "8", with some modification as hereinafter set forth, will produce the additional revenue required and at the same time effect a broad distribution over the entire spectrum of the ridership of this system. Therefore, we prescribe that the existing fare structure remain in effect, except for the following changes:

1. D. C. cash fare raised to 27¢
2. Token fare is raised to 25¢, to be sold in increments of four for \$1.00
3. The Maryland intrastate fare is raised in zones 1 and 2 to 27¢ 6/
4. The interstate local zones 2 and 3 are raised 5¢ each to 50¢ and 60¢ respectively

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6/ This would cover the bulk of the intrastate Maryland riders.

The revenue to be generated from the change in fares is computed as follows:

Staff Alternate "8" (Exh. No. S-46, 47)	\$1,110,755
Exclude: (a) zone 3 local	38,732
(b) interstate express	95,000
(c) D. C. Stadium	<u>5,023</u>
	\$ 972,000

Table III

PROJECTED OPERATING STATEMENT FOR THE FUTURE AT  
FARES PRESCRIBED BY THE COMMISSION

Operating Revenues:

Passenger Revenue	\$ 35,292,612
Charter	2,229,650
Government	127,790
Limousine	--
Station and Vehicle	169,153
Other	<u>76,255</u>
Total	<u>\$ 37,895,460</u>

Operating Revenue Deductions:

Operating Expenses	\$ 31,997,863
Taxes, Other than Income Taxes	1,074,753
Income Taxes	598,299
Depreciation	2,394,647
Commission Directed Credits	--
Amortization of the Acquisition Adjustment	<u>(194,516)</u>
Total	<u>\$ 35,871,046</u>

Net Operating Income \$ 2,024,414

Rate of Return 5.34%

Operating Ratio 94.66%



The revised fare structure will enable Transit to retain the attractive advantage of a cheap form of transportation when compared with the cost of movement by private automobiles. Moreover, this fare structure will afford the citizens of the Washington Metropolitan District served by D. C. Transit a public transportation service at a cost generally below that offered in other metropolitan areas, either by private or public transportation systems. It is our opinion that these rates will have the least effect upon the movement of traffic by this carrier of the various fare structures suggested. Moreover, it is our opinion that it will produce the least resistance required by an increase in fares and at the same time serve as an attraction to new patrons, thereby continuing the upward trend in growth which has been experienced in the past several years.

We conclude therefore, that the fare structure we establish in this order is a just and reasonable one. The distribution of the burden of the increase falls equitably between riders and sections of the metropolitan area.

We need only note one further point. The fares we establish hereby will become effective at 12:01 A.M. on January 28, 1968. The 150 day period during which we can suspend the company's proposed fare structure expires at that time so we have little choice in the matter of timing. In any event, this timing is in keeping with our usual practice when changing the price of tokens.

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#### FINDINGS OF FACT

We have stated our findings of fact on the issues in this proceeding in our discussion hereinbefore.

#### CONCLUSION OF LAW

The Commission concludes as a matter of law:

1. That the present fare structure of applicant is unjust and unreasonable in that it will not produce sufficient revenues in the future to enable the carrier to meet operating expenses and earn a reasonable return.
2. That the fares proposed by applicant would be unjust and unreasonable in that they would produce net operating revenues in excess of a fair return.
3. That the fares authorized by this order are just and reasonable. They are not unduly preferential nor unduly discriminatory either between riders or sections of the Metropolitan District. They are necessary to enable this carrier, under honest, economical, and efficient management, to provide an adequate and efficient transportation service, and they provide the means whereby this carrier may provide an adequate and efficient transportation service in the lowest cost consistent with the furnishing of such service. They will, moreover, afford this carrier the opportunity of earning that return which we have found is necessary to make it an attractive investment to private investors.

THEREFORE, IT IS ORDERED:

1. That the fares proposed by D. C. Transit System, Inc., in tariffs filed September 1, 1967, and previously described in and suspended by Order No. 739, and further suspended by Order No. 766, be, and they are hereby, denied.

2. That applicant, D. C. Transit System, Inc., be, and it is hereby, authorized to file a tariff on or before January 27, 1968, to become effective at or after 12:01 A.M., January 28, 1968, reflecting the following changes in fares:

- (a) Cash fare - D. C.: 27¢
  - (b) Token fare: Four (4) tokens for \$1.00; provided, outstanding tokens shall be honored as though purchased at new rate.
  - (c) Interstate Local Zone 2: 50¢; Zone 3: 60¢
  - (d) Maryland Intrastate Local Service: 27¢ cash for the first two zones of carriage; or any part thereof; 8¢ additional cash for the third zone, or any part thereof.
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3. That the applicant shall make the proper entries on its official books and records, effective January 1, 1968, to reflect:

- (a) the disallowance of expenses incurred in transporting sightseeing passengers from points in Virginia to its sightseeing terminal in the District of Columbia;
- (b) operating revenue at the rate of \$23,400 per annum for distributing the D. C. Examiner newspaper;
- (c) the amortization of the Health and Welfare assessment for a period of 22 months ending October 31, 1969;
- (d) the disallowance of \$7,510 per year for rent at 1420 New York Avenue, District of Columbia;
- (e) the special fund in the amount of \$141,674; the company shall debit its earned surplus account accordingly and establish a "Reserve for Commission-Ordered Projects" for that amount. To this end, a special account shall be established and actually funded on or before February 15, 1968; no expenditure shall be made from this fund except upon the express written approval and directive of the Commission.

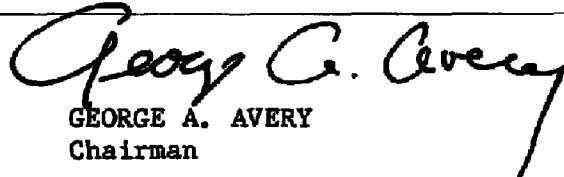
4. That the program for purchasing new buses established by the Commission in its Order No. 362 be, and it is hereby, modified to provide that the applicant shall purchase on the average each year, beginning June 1, 1968, a number of new air-conditioned buses equal to 1/14th of the number of buses in its fleet. Retirements of buses shall be subject to review and approval by the Commission.

5. The applicant shall purchase 85 new air-conditioned buses for use in its mass transit operations, such buses to be delivered prior to June 1, 1968. Not later than February 10, 1968, the applicant shall submit satisfactory proof to the Commission that such an order has been placed.

6. That, contingent on the compliance by applicant with paragraphs 4 and 5 of this order, the cost of all buses acquired by it subsequent to 1956 shall be amortized, beginning February 1, 1968, in the form of depreciation charges in equal monthly amounts over a period of time so as to allow the recovery of the net book value, as of January 31, 1968, less a salvage value of 4% of the original cost new, in 14 years from the date such buses were first placed in service.

BY DIRECTION OF THE COMMISSION:

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GEORGE A. AVERY  
Chairman

HOOKE, Commissioner, did not participate in the decision on this matter for the reason that he was unable to be present at any of the hearings.

APPENDIX

ORDER NO. 773

	<u>Fares in Effect Prior to This Order</u>	<u>Transit's Proposed Fares</u>	<u>Fares Authorized Herein</u>
<u>District of Columbia</u>			
Cash	\$.25	\$.30	\$.27
Token	.2450 (4/98¢)	.275 (4/1.10)	.25 (4/1.00)
Interline	.35+5¢	Discontinue	.35+5¢
Capitol Hill Express	.60 (a)	.60 (c)	.60 (f)
Minibus	.10	.10	.10
School	.10	.10	.10
Transfer	Free	.05	Free
<u>Maryland</u>			
<u>Intrastate Local</u>			
Zones 1	.25	.25	.27
2	.25	.25	.27
3	.35	.35	.35
4	.45	.45	.45
5	.50	.50	.50
6	.55	.55	.55
7	.60	.60	.60
8	.65	.65	.65
9	.70	.70	.70
10	.75	.75	.75
11	.80	.80	.80
12	.85	.85	.85
<u>Interstate Local</u>			
Zones 1	.40 (b)	.55 (d)	.40 (b)
2	.45 (b)	.55 (d)	.50 (b)
3	.55 (b)	.65 (d)	.60 (b)
4	.65 (b)	.75 (d)	.65 (b)
5	.70 (b)	.80 (d)	.70 (b)
6	.75 (b)	.85 (d)	.75 (b)
7	.80 (b)	.90 (d)	.80 (b)
8	.85 (b)	.95 (d)	.85 (b)
9	.90 (b)	1.00 (d)	.90 (b)
10	.95 (b)	1.05 (d)	.95 (b)
11	1.00 (b)	1.10 (d)	1.00 (b)
12	1.05 (b)	1.15 (d)	1.05 (b)

	<u>Fares in Effect Prior to This Order</u>	<u>Transit's Proposed Fares</u>	<u>Fares Authorized Herein</u>
Interstate Express			
Md. - D.C. Line	\$.35 (b)	\$.40 (e)	\$.35 (b)
Zones 1	.50 (b)	.55 (e)	.50 (b)
2	.60 (b)	.65 (e)	.60 (b)
3	.70 (b)	.75 (e)	.70 (b)
4	.80 (b)	.85 (e)	.80 (b)
5	.85 (b)	.90 (e)	.85 (b)
6	.90 (b)	.95 (e)	.90 (b)
7	.95 (b)	1.00 (e)	.95 (b)
8	1.00 (b)	1.05 (e)	1.00 (b)
9	1.05 (b)	1.10 (e)	1.05 (b)
10	1.10 (b)	1.15 (e)	1.10 (b)
11	1.15 (b)	1.20 (e)	1.15 (b)
12	1.20 (b)	1.25 (e)	1.20 (b)
<u>Other</u>			
Silver Rocket	.35 3 Zones .10 ea. add'l. zone	.35 3 Zones .10 ea. add'l. zone	.35 3 Zones .10 ea. add'l. zone
	<u>Transfer Privilege</u>	<u>Transfer Discontinued</u>	<u>Transfer Privilege</u>
Stadium	.60	.75	.60
Virginia Interstate Zone (Route C-1 Langley)	.10	.10	.10

- (a) or valid transfer plus 40¢ cash
- (b) valid transfer or token has 25¢ value toward total cash fare
- (c) or valid transfer plus 33¢ cash
- (d) valid transfer or token has 30¢ value toward total cash fare
- (e) valid transfer or token has 27¢ value toward total cash fare
- (f) or valid transfer plus 35¢ cash